

BankFinancial CORP
Form 10-Q
October 28, 2015

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

FORM 10-Q

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

For the Quarterly Period ended September 30, 2015

or

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

For transition period from _____ to _____
Commission File Number 0-51331

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

Maryland
(State or Other Jurisdiction
of Incorporation)

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

15W060 North Frontage Road, Burr Ridge, Illinois 60527

(Address of Principal Executive Offices)

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

Not Applicable

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

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

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

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

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

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

Indicate the number of shares outstanding of each of the Issuer's classes of common stock as of the latest practicable date. At October 26, 2015, there were 20,501,966 shares of Common Stock, \$0.01 par value, outstanding.

BANKFINANCIAL CORPORATION

Form 10-Q

September 30, 2015

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

	September 30, 2015	December 31, 2014
Assets		
Cash and due from other financial institutions	\$8,809	\$9,693
Interest-bearing deposits in other financial institutions	52,661	49,888
Cash and cash equivalents	61,470	59,581
Securities, at fair value	104,242	121,174
Loans receivable, net of allowance for loan losses: September 30, 2015, \$10,081 and December 31, 2014, \$11,990	1,162,298	1,172,356
Other real estate owned, net	4,809	6,358
Stock in Federal Home Loan Bank, at cost	6,257	6,257
Premises and equipment, net	33,063	34,286
Accrued interest receivable	4,000	3,926
Core deposit intangible	1,441	1,855
Bank owned life insurance	22,335	22,193
Deferred taxes	27,733	31,643
Other assets	3,775	5,781
Total assets	\$1,431,423	\$1,465,410
Liabilities		
Deposits		
Noninterest-bearing	\$233,192	\$134,129
Interest-bearing	948,342	1,077,584
Total deposits	1,181,534	1,211,713
Borrowings	18,048	12,921
Advance payments by borrowers for taxes and insurance	7,755	11,489
Accrued interest payable and other liabilities	11,012	13,166
Total liabilities	1,218,349	1,249,289
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; 20,501,966 shares issued at September 30, 2015 and 21,101,966 shares issued at December 31, 2014	205	211
Additional paid-in capital	186,992	193,845
Retained earnings	34,815	31,584
Unearned Employee Stock Ownership Plan shares	(9,544	) (10,276)
Accumulated other comprehensive income	606	757
Total stockholders' equity	213,074	216,121
Total liabilities and stockholders' equity	\$1,431,423	\$1,465,410

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 September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Interest and dividend income				
Loans, including fees	\$ 11,792	\$ 11,983	\$ 35,451	\$ 35,767
Securities	267	283	851	866
Other	88	102	249	303
Total interest income	12,147	12,368	36,551	36,936
Interest expense				
Deposits	695	744	2,068	2,327
Borrowings	4	2	8	5
Total interest expense	699	746	2,076	2,332
Net interest income	11,448	11,622	34,475	34,604
Provision for (recovery of) loan losses	(956	) (1,413	) (2,168	) 20
Net interest income after provision for (recovery of) loan losses	12,404	13,035	36,643	34,584
Noninterest income				
Deposit service charges and fees	562	527	1,493	1,438
Other fee income	502	563	1,638	1,677
Insurance commissions and annuities income	68	106	217	279
Gain on sale of loans, net	37	39	92	107
Loss on sale of securities (includes \$7 accumulated other comprehensive income reclassifications for unrealized net losses on available for sale securities for the nine months ended September 30, 2014)	—	—	—	(7
Gain (loss) on disposition of premises and equipment, net	—	—	(1	) 5
Loan servicing fees	85	102	271	310
Amortization and impairment of servicing assets	(50	) (32	) (107	) (112
Earnings on bank owned life insurance	48	57	142	182
Trust	172	171	529	505
Other	285	215	660	556
	1,709	1,748	4,934	4,940
Noninterest expense				
Compensation and benefits	5,329	5,492	16,188	17,046
Office occupancy and equipment	1,537	1,687	4,902	5,227
Advertising and public relations	212	272	783	741
Information technology	686	674	1,982	2,004
Supplies, telephone, and postage	393	394	1,189	1,169
Amortization of intangibles	136	143	414	435
Nonperforming asset management	244	418	442	619
Operations of other real estate owned	334	494	780	1,160
FDIC insurance premiums	202	208	699	1,157
Other	1,159	1,375	3,397	3,952
	10,232	11,157	30,776	33,510
Income before income taxes	3,881	3,626	10,801	6,014
Income tax expense	1,532	36	4,242	78

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Net income	\$2,349	\$3,590	\$6,559	\$5,936
Basic earnings per common share	\$0.12	\$0.17	\$0.33	\$0.29
Diluted earnings per common share	\$0.12	\$0.17	\$0.33	\$0.29
Weighted average common shares outstanding	19,725,707	20,218,951	19,999,089	20,154,912
Diluted weighted average common shares outstanding	19,731,302	20,235,407	20,004,694	20,170,964

See accompanying notes to the consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net income	\$2,349	\$3,590	\$6,559	\$5,936
Unrealized holding loss arising during the period	(34	) (26	) (244	) (52
Tax effect	13	—	93	—
Unrealized holding loss arising during the period, net of tax	(21	) (26	) (151	) (52
Reclassification adjustment for losses included in net income	—	—	—	7
Other comprehensive loss	(21	) (26	) (151	) (45
Comprehensive income	\$2,328	\$3,564	\$6,408	\$5,891

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 (Loss)	Total
Balance at January 1, 2014	\$211	\$193,594	\$(7,342)	\$(11,255)	\$ 419	\$175,627
Net income	—	—	5,936	—	—	5,936
Other comprehensive loss, net of tax	—	—	—	—	(45)	(45)
Nonvested stock awards-stock-based compensation expense	—	52	—	—	—	52
Cash dividends declared on common stock (\$0.05 per share)	—	—	(1,055)	—	—	(1,055)
ESOP shares earned	—	28	—	733	—	761
Balance at September 30, 2014	\$211	\$193,674	\$(2,461)	\$(10,522)	\$ 374	\$181,276
Balance at January 1, 2015	\$211	\$193,845	\$31,584	\$(10,276)	\$ 757	\$216,121
Net income	—	—	6,559	—	—	6,559
Other comprehensive loss, net of tax	—	—	—	—	(151)	(151)
Repurchase and retirement of common stock (600,000 shares)	(6)	(7,382)	—	—	—	(7,388)
Nonvested stock awards-stock-based compensation expense, net of tax	—	351	—	—	—	351
Cash dividends declared on common stock (\$0.16 per share)	—	—	(3,328)	—	—	(3,328)
ESOP shares earned	—	178	—	732	—	910
Balance at September 30, 2015	\$205	\$186,992	\$34,815	\$(9,544)	\$ 606	\$213,074

See accompanying notes to the consolidated financial statements.

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

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities		
Net income	\$6,559	\$5,936
Adjustments to reconcile to net income to net cash from operating activities		
Provision for (recovery of) loan losses	(2,168	) 20
ESOP shares earned	910	761
Stock-based compensation expense	351	52
Depreciation and amortization	2,754	2,864
Amortization of premiums and discounts on securities and loans	(214	) (325
Amortization of core deposit intangible	414	435
Amortization and impairment of servicing assets	107	112
Net change in net deferred loan origination costs	(384	) (99
Net gain on sale of other real estate owned	(91	) (40
Net gain on sale of loans	(92	) (107
Net loss on sale of securities	—	7
Net loss (gain) on disposition of premises and equipment	1	(5
Loans originated for sale	(3,593	) (3,492
Proceeds from sale of loans	3,685	3,599
Other real estate owned valuation adjustments	467	392
Net change in:		
Accrued interest receivable	(74	) 343
Earnings on bank owned life insurance	(142	) (182
Other assets	5,906	3,638
Accrued interest payable and other liabilities	(2,154	) (13
Net cash from operating activities	12,242	13,896
Cash flows from investing activities		
Securities		
Proceeds from maturities	53,410	43,924
Proceeds from principal repayments	5,888	5,259
Proceeds from sales of securities	—	3,663
Purchases of securities	(42,643	) (57,023
Loans receivable		
Loan participations sold	3,350	—
Principal payments on loans receivable	333,644	322,271
Originated for investment	(326,624	) (363,909
Purchase of Federal Home Loan Bank of Chicago stock	—	(189
Proceeds from sale of other real estate owned	2,487	3,790
Purchase of premises and equipment, net	(363) (362
Net cash from (used in) investing activities	29,149	(42,576

Continued

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

	Nine Months Ended September 30,	
	2015	2014
Cash flows from financing activities		
Net change in deposits	\$(30,179)	\$(34,406)
Net change in borrowings	5,127	(221)
Net change in advance payments by borrowers for taxes and insurance	(3,734)	(3,670)
Stock repurchased	(7,388)	—
Cash dividends paid on common stock	(3,328)	(1,055)
Net cash used in financing activities	(39,502)	(39,352)
Net change in cash and cash equivalents	1,889	(68,032)
Beginning cash and cash equivalents	59,581	160,957
Ending cash and cash equivalents	\$61,470	\$92,925
Supplemental disclosures of cash flow information:		
Interest paid	\$2,113	\$2,344
Income taxes paid	262	114
Loans transferred to other real estate owned	1,314	3,836

See accompanying notes to the consolidated financial statements.

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Principles of Consolidation: The interim unaudited consolidated financial statements include the accounts of and transactions of BankFinancial Corporation, the Bank, and the Bank’s wholly-owned subsidiaries, Financial Assurance Services, Inc. and BF Asset Recovery Corporation (collectively, “the Company”), and reflect all normal and recurring adjustments that are, in the opinion of management, considered necessary for a fair presentation of the financial condition and results of operations for the periods presented. All significant intercompany accounts and transactions have been eliminated. The results of operations for the three- and nine-month periods ended September 30, 2015 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2015. Certain information and note disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

Use of Estimates: To prepare financial statements in conformity with GAAP, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ.

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

These unaudited consolidated financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2014, as filed with the Securities and Exchange Commission.

Recent Accounting Pronouncements

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

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

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

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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 (continued)

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

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 September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income available to common stockholders	\$2,349	\$3,590	\$6,559	\$5,936
Average common shares outstanding	20,501,966	21,101,966	20,803,065	21,101,966
Less:				
Unearned ESOP shares	(768,327)	(866,193)	(792,551)	(926,705)
Unvested restricted stock shares	(7,932)	(16,822)	(11,425)	(20,349)
Weighted average common shares outstanding	19,725,707	20,218,951	19,999,089	20,154,912
Add - Net effect of dilutive stock options and unvested restricted stock	5,595	16,456	5,605	16,052
Diluted weighted average common shares outstanding	19,731,302	20,235,407	20,004,694	20,170,964
Basic earnings per common share	\$0.12	\$0.17	\$0.33	\$0.29
Diluted earnings per common share	\$0.12	\$0.17	\$0.33	\$0.29

Stock options for 1,215,697 shares of common stock were not considered in computing diluted earnings per share for the period ended September 30, 2015 because they were antidilutive.

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 3 - SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2015				
Certificates of deposit	\$76,194	\$—	\$—	\$76,194
Equity mutual fund	500	12	—	512
Mortgage-backed securities - residential	18,944	957	(25)	19,876
Collateralized mortgage obligations - residential	7,596	49	(10)	7,635
SBA-guaranteed loan participation certificates	25	—	—	25
	\$103,259	\$1,018	\$(35)	\$104,242
December 31, 2014				
Certificates of deposit	\$86,049	\$—	\$—	\$86,049
Equity mutual fund	500	9	—	509
Mortgage-backed securities - residential	23,433	1,218	(40)	24,611
Collateralized mortgage obligations - residential	9,936	53	(13)	9,976
SBA-guaranteed loan participation certificates	29	—	—	29
	\$119,947	\$1,280	\$(53)	\$121,174

Mortgage-backed securities and collateralized mortgage obligations reflected in the preceding table were issued by U.S. government-sponsored entities or agencies, Freddie Mac, Fannie Mae and Ginnie Mae, and are obligations which the U.S. government has affirmed its commitment to support. All securities reflected in the preceding table were classified as available-for-sale at September 30, 2015 and December 31, 2014.

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

	September 30, 2015	
	Amortized Cost	Fair Value
Due in one year or less	\$76,194	\$76,194
Equity mutual fund	500	512
Mortgage-backed securities - residential	18,944	19,876
Collateralized mortgage obligations - residential	7,596	7,635
SBA-guaranteed loan participation certificates	25	25
	\$103,259	\$104,242

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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)

Sales of securities were as follows:

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

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

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
September 30, 2015						
Mortgage-backed securities - residential	\$—	\$—	\$1,743	\$(25)	\$1,743	\$(25)
Collateralized mortgage obligations - residential	—	—	1,405	(10)	1,405	(10)
	\$—	\$—	\$3,148	\$(35)	\$3,148	\$(35)
December 31, 2014						
Mortgage-backed securities - residential	\$—	\$—	\$2,126	\$(40)	\$2,126	\$(40)
Collateralized mortgage obligations - residential	—	—	1,847	(13)	1,847	(13)
	\$—	\$—	\$3,973	\$(53)	\$3,973	\$(53)

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

Certain residential mortgage-backed securities and certain collateralized mortgage obligations that the Company holds in its investment portfolio were in an unrealized loss position at September 30, 2015, but the unrealized losses were not considered significant under the Company's impairment testing methodology. In addition, the Company does not intend to sell these securities, and it is likely that the Company will not be required to sell these securities before their anticipated recovery occurs.

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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

Loans receivable are as follows:

	September 30, 2015	December 31, 2014
One-to-four family residential real estate	\$164,124	\$180,337
Multi-family mortgage	478,057	480,349
Nonresidential real estate	223,528	234,500
Construction and land	1,322	1,885
Commercial loans	80,216	66,882
Commercial leases	221,622	217,143
Consumer	1,927	2,051
	1,170,796	1,183,147
Net deferred loan origination costs	1,583	1,199
Allowance for loan losses	(10,081	) (11,990
Loans, net	\$1,162,298	\$1,172,356

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

	Allowance for loan losses			Loan Balances		
	Individually evaluated for impairment	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Collectively evaluated for impairment	Total
September 30, 2015						
One-to-four family residential real estate	\$—	\$1,601	\$1,601	\$3,353	\$160,771	\$164,124
Multi-family mortgage	3	3,885	3,888	3,487	474,570	478,057
Nonresidential real estate	66	2,629	2,695	4,097	219,431	223,528
Construction and land	—	74	74	—	1,322	1,322
Commercial loans	17	772	789	75	80,141	80,216
Commercial leases	—	1,006	1,006	—	221,622	221,622
Consumer	—	28	28	—	1,927	1,927
	\$86	\$9,995	\$10,081	\$11,012	\$1,159,784	1,170,796
Net deferred loan origination costs						1,583
Allowance for loan losses						(10,081
Loans, net) \$1,162,298

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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)

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

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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		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Beginning balance	\$10,810	\$14,452	\$11,990	\$14,154
Loans charged off:				
One-to-four family residential real estate	(125	) (298	) (327	) (644
Multi-family mortgage	(9	) (97	) (189	) (781
Nonresidential real estate	(26	) (695	) (289	) (1,461
Construction and land	—	—	—	(1
Commercial loans	—	(78	) (98	) (100
Commercial leases	—	(8	) —	(8
Consumer	(3	) —	(11	) (10
	(163	) (1,176	) (914	) (3,005
Recoveries:				
One-to-four family residential real estate	16	26	295	134
Multi-family mortgage	169	11	177	31
Nonresidential real estate	24	116	49	400
Construction and land	38	29	44	287
Commercial loans	143	1,005	606	1,027
Commercial leases	—	—	1	—
Consumer	—	1	1	3
	390	1,188	1,173	1,882
Net recoveries (charge-offs)	227	12	259	(1,123
Provision for (recovery of) loan losses	(956	) (1,413	) (2,168	) 20
Ending balance	\$10,081	\$13,051	\$10,081	\$13,051

Purchased Impaired Loans

As a result of its acquisition of Downers Grove National Bank, the Company holds purchased loans for which there was evidence of deterioration of credit quality since origination and for which it was probable that all contractually required payments would not be collected as of the date of the acquisition. The Company held one purchased impaired loan at September 30, 2015 and December 31, 2014, with a recorded investment value of \$52,000.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

Impaired loans

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

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

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

					Three months ended September 30, 2015	September 30, 2015	Nine months ended September 30, 2015	September 30, 2015
	Loan Balance	Recorded Investment	Partial Charge-off	Allowance for Loan Losses Allocated	Average Investment in Impaired Loans	Interest Income Recognized	Average Investment in Impaired Loans	Interest Income Recognized
September 30, 2015								
With no related allowance recorded:								
One-to-four family residential real estate	\$3,543	\$ 2,830	\$ 785	\$ —	\$2,742	\$ 6	\$2,674	\$ 19
One-to-four family residential real estate - non-owner occupied	567	520	57	—	704	6	1,126	31
Multi-family mortgage	2,763	2,739	—	—	1,970	19	1,856	69
Wholesale commercial lending	513	508	—	—	510	9	515	26
Nonresidential real estate	2,907	2,682	212	—	2,741	24	2,999	97
	10,293	9,279	1,054	—	8,667	64	9,170	242
With an allowance recorded:								
Multi-family mortgage	238	233	—	3	587	—	1,483	—
Nonresidential real estate	1,481	1,389	67	66	1,106	—	2,114	14
Commercial loans - secured	76	75	—	17	19	—	8	—
	1,795	1,697	67	86	1,712	—	3,605	14
Total	\$12,088	\$ 10,976	\$ 1,121	\$ 86	\$10,379	\$ 64	\$12,775	\$ 256

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

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

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

Nonaccrual Loans

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

	Loan Balance	Recorded Investment	Loans Past Due Over 90 Days, Still Accruing
September 30, 2015			
One-to-four family residential real estate	\$3,139	\$2,539	\$—
One-to-four family residential real estate – non owner occupied	359	413	—
Multi-family mortgage	1,482	1,399	—
Nonresidential real estate	2,575	2,263	—
Commercial loans – secured	76	75	—
	\$7,631	\$6,689	\$—
December 31, 2014			
One-to-four family residential real estate	\$4,793	\$4,210	\$—
One-to-four family residential real estate – non owner occupied	291	198	—
Multi-family mortgage	5,638	4,481	—
Nonresidential real estate	4,023	3,245	—
Commercial loans – secured	76	76	—
Consumer	3	3	—
	\$14,824	\$12,213	\$—

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

The Company's reserve for uncollected loan interest was \$275,000 and \$464,000 at September 30, 2015 and December 31, 2014, respectively. When a loan is on non-accrual status and the ultimate collectability of the total principal of the loan is in doubt, all payments are applied to principal under the cost recovery method. Alternatively, when a loan is on non-accrual status but there is doubt concerning only the ultimate collectability of interest, contractual interest is credited to interest income only when received, under the cash basis method pursuant to the provisions of FASB ASC 310-10, as applicable. In all cases, the average balances are calculated based on the month-end balances of the financing receivables within the period reported pursuant to the provisions of FASB ASC 310-10, as applicable.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

Past Due Loans

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

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
One-to-four family residential real estate	\$61	\$376	\$2,272	\$2,709	\$117,063	\$119,772
One-to-four family residential real estate - non-owner occupied	3	—	413	416	43,895	44,311
Multi-family mortgage	517	178	882	1,577	317,154	318,731
Wholesale commercial lending	—	399	—	399	156,295	156,694
Nonresidential real estate	—	—	2,262	2,262	219,879	222,141
Construction	—	—	—	—	31	31
Land	—	—	—	—	1,289	1,289
Commercial loans:						
Secured	—	—	75	75	22,731	22,806
Unsecured	—	—	—	—	3,217	3,217
Municipal	—	—	—	—	1,610	1,610
Warehouse lines	—	—	—	—	15,406	15,406
Health care	—	—	—	—	20,030	20,030
Aviation	—	—	—	—	1,023	1,023
Other	—	—	—	—	16,425	16,425
Commercial leases:						
Investment rated commercial leases	—	20	—	20	159,008	159,028
Below investment grade	—	—	—	—	7,377	7,377
Non-rated	—	86	—	86	46,341	46,427
Lease pools	—	—	—	—	10,257	10,257
Consumer	—	—	—	—	1,935	1,935
	\$581	\$1,059	\$5,904	\$7,544	\$1,160,966	\$1,168,510

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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, 2014 by class of loans:

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

Troubled Debt Restructurings

The Company evaluates loan extensions or modifications in accordance with FASB ASC 310-40 with respect to the classification of the loan as a TDR. In general, if the Company grants a loan extension or modification to a borrower for other than an insignificant period of time that includes a below-market interest rate, principal forgiveness, payment forbearance or other concession intended to minimize the economic loss to the Company, the loan extension or loan modification is classified as a TDR. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal then due and payable, management measures any impairment on the restructured loan in the same manner as for impaired loans as noted above.

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

The following table presents loans classified as TDRs:

	September 30, 2015	December 31, 2014
One-to-four family residential real estate	\$1,657	\$1,917
Multi-family mortgage	1,126	510
Troubled debt restructured loans – accrual loans	2,783	2,427
One-to-four family residential real estate	208	230
Multi-family mortgage	—	346
Troubled debt restructured loans – nonaccrual loans	208	576
Total troubled debt restructured loans	\$2,991	\$3,003

During the three and nine months ending September 30, 2015 and 2014, the terms of certain loans were modified and classified as TDRs. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan. The following tables present TDR activity:

	Three Months Ended September 30, 2015		2014		Pre- Modification outstanding recorded investment	Post- Modification outstanding recorded investment	Total
	Number of loans	Pre- Modification outstanding recorded investment	Post- Modification outstanding recorded investment	Number of loans				Pre- Modification outstanding recorded investment	Post- Modification outstanding recorded investment
One-to-four family residential real estate	5	\$ 338	\$ 211	1	\$ 345	\$ 345	
Commercial loans - secured	—	—	—	1	210	5	
Total	5	\$ 338	\$ 211	2	\$ 555	\$ 350	
					Due to permanent reduction in recorded investment		
		Due to reduction in interest rate	Due to extension of maturity date				

For the Three Months Ended September 30, 2015

One-to-four family residential real estate	\$—	\$ 79	\$ 132	\$ 211
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For the Three Months Ended September 30, 2014

One-to-four family residential real estate	\$—	\$ 345	\$—	\$ 345
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Commercial loans - secured	—	—	5	5
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Total	\$—	\$ 345	\$ 5	\$ 350
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The TDRs described above had no impact on interest income, resulted in no change to the allowance for loan losses allocated and resulted in charge-offs of \$127,000 for the three months ended September 30, 2015. The TDRs had no impact on interest income, resulted in no change to the allowance for loan losses allocated and resulted in \$205,000 of charge-offs for the three months ended September 30, 2014.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

	Nine Months Ended September 30, 2015		2014			
	Number of loans	Pre- Modification outstanding recorded investment	Post- Modification outstanding recorded investment	Number of loans	Pre- Modification outstanding recorded investment	Post- Modification outstanding recorded investment
One-to-four family residential real estate	6	\$ 401	\$ 274	4	\$ 485	\$ 444
Commercial loans - secured	—	—	—	1	210	5
Total	6	\$ 401	\$ 274	5	\$ 695	\$ 449
		Due to reduction in interest rate	Due to extension of maturity date	Due to permanent reduction in recorded investment	Total	
For the Nine Months Ended September 30, 2015						
One-to-four family residential real estate		\$—	\$ 142	\$ 132	\$ 274	
For the Nine Months Ended September 30, 2014						
One-to-four family residential real estate		\$ 19	\$ 373	\$ 52	\$ 444	
Commercial loans - secured		—	—	5	5	
Total		\$ 19	\$ 373	\$ 57	\$ 449	

The TDRs described above had no material impact on interest income, resulted in no change to the allowance for loan losses allocated and resulted in \$127,000 of charge-offs for the nine months ended September 30, 2015. The TDRs decreased interest income by \$1,000, resulted in no change to the allowance for loan losses allocated and resulted in charge-offs of \$246,000 for the nine months ended September 30, 2014.

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

	2015		2014	
	Number of loans	Recorded investment	Number of loans	Recorded investment
One-to-four family residential real estate	1	\$27	1	\$28

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

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

There were certain other loan modifications during the three and nine months ending September 30, 2015 and 2014 that did not meet the definition of a TDR. These loans had a total recorded investment of \$2.6 million and \$1.6 million at September 30, 2015 and 2014, respectively. The modification of these loans involved either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

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

Credit Quality Indicators

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, including current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans based on credit risk.

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

NOTE 4 - LOANS RECEIVABLE (continued)

This analysis includes non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on a monthly basis. The Company uses the following definitions for risk ratings:

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

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

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

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

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

	Pass	Special Mention	Substandard	Nonaccrual	Total
One-to-four family residential real estate	\$ 117,242	\$—	\$429	\$2,114	\$ 119,785
One-to-four family residential real estate - non-owner occupied	43,705	223	—	411	44,339
Multi-family mortgage	312,554	456	5,741	1,404	320,155
Wholesale commercial lending	157,389	—	513	—	157,902
Nonresidential real estate	197,920	18,065	5,259	2,284	223,528
Construction	31	—	—	—	31
Land	472	—	819	—	1,291
Commercial loans:					
Secured	22,509	—	148	75	22,732
Unsecured	2,651	—	555	—	3,206
Municipal	1,599	—	—	—	1,599
Warehouse lines	16,369	—	—	—	16,369
Health care	19,995	—	—	—	19,995
Aviation	1,021	—	—	—	1,021
Other	15,294	—	—	—	15,294
Commercial leases:					
Investment rated commercial leases	157,893	—	—	—	157,893
Below investment grade	7,336	—	—	—	7,336
Non-rated	46,175	—	—	—	46,175
Lease pools	10,218	—	—	—	10,218
Consumer	1,927	—	—	—	1,927
Total	\$ 1,132,300	\$ 18,744	\$ 13,464	\$ 6,288	\$ 1,170,796

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

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

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

NOTE 5 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase are shown below.

	September 30, 2015				Total
	Overnight and Continuous	Up to 30 days	30 - 90 days	Greater Than 90 days	
Repurchase agreements and repurchase-to-maturity transactions	\$3,048	\$—	\$—	\$—	\$3,048
Gross amount of recognized liabilities for repurchase agreements in Statement of Condition					\$3,048
	December 31, 2014				Total
	Overnight and Continuous	Up to 30 days	30 - 90 days	Greater Than 90 days	
Repurchase agreements and repurchase-to-maturity transactions	\$2,921	\$—	\$—	\$—	\$2,921
Gross amount of recognized liabilities for repurchase agreements in Statement of Condition					\$2,921

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

Securities sold under agreements to repurchase were secured by mortgage-backed securities with a carrying amount of \$6.1 million and \$6.8 million at September 30, 2015 and December 31, 2014, respectively. Also included in total borrowings were advances from the Federal Home Loan Bank of Chicago (the "FHLBC") of \$15.0 million and \$10.0 million at September 30, 2015 and December 31, 2014, respectively.

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

NOTE 6 - FAIR VALUE

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

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

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

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

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

Securities: The fair values of marketable equity securities are generally determined by quoted prices, in active markets, for each specific security (Level 1). If Level 1 measurement inputs are not available for a marketable equity security, we determine its fair value based on the quoted price of a similar security traded in an active market (Level 2). The fair values of debt securities are generally determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2).

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available for similar loans and collateral underlying such loans. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted in accordance with the allowance policy.

Other Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach with data from comparable properties. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Real estate owned properties are evaluated on a quarterly basis for

additional impairment and adjusted accordingly.

Mortgage Servicing Rights: On a quarterly basis, loan servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. The fair values of mortgage servicing rights are based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income. The Company is able to compare the valuation model inputs and results to widely available published industry data for reasonableness (Level 2).

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

NOTE 6 - FAIR VALUE (continued)

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

	Fair Value Measurements Using			
	Quoted	Significant	Significant	Fair
	Prices in	Observable	Unobservable	Value
	Active	Inputs	Inputs	
	Markets for	(Level 2)	(Level 3)	
	Identical			
	Assets			
	(Level 1)			
September 30, 2015				
Securities:				
Certificates of deposit	\$—	\$76,194	\$—	\$76,194
Equity mutual fund	512	—	—	512
Mortgage-backed securities – residential	—	19,876	—	19,876
Collateralized mortgage obligations – residential	—	7,635	—	7,635
SBA-guaranteed loan participation certificates	—	25	—	25
	\$512	\$103,730	\$—	\$104,242
December 31, 2014				
Securities:				
Certificates of deposit	\$—	\$86,049	\$—	\$86,049
Equity mutual fund	509	—	—	509
Mortgage-backed securities - residential	—	24,611	—	24,611
Collateralized mortgage obligations – residential	—	9,976	—	9,976
SBA-guaranteed loan participation certificates	—	29	—	29
	\$509	\$120,665	\$—	\$121,174

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6 - FAIR VALUE (continued)

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

	Fair Value Measurement Using			Fair Value
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
September 30, 2015				
Impaired loans:				
Multi-family mortgage	\$—	\$—	\$230	\$230
Nonresidential real estate	—	—	1,323	1,323
Commercial loans	—	—	58	58
	\$—	\$—	\$1,611	\$1,611
Other real estate owned:				
One-to-four family residential real estate	\$—	\$—	\$42	\$42
Multi-family mortgage	—	—	962	962
Nonresidential real estate	—	—	107	107
Land	—	—	749	749
	\$—	\$—	\$1,860	\$1,860
Mortgage servicing rights	\$—	\$297	\$—	\$297
December 31, 2014				
Impaired loans:				
One-to-four family residential real estate	\$—	\$—	\$70	\$70
Multi-family mortgage	—	—	1,905	1,905
Nonresidential real estate	—	—	2,369	2,369
	\$—	\$—	\$4,344	\$4,344
Other real estate owned:				
One-to-four family residential real estate	\$—	\$—	\$55	\$55
Multi-family mortgage	—	—	1,265	1,265
Nonresidential real estate	—	—	126	126
Land	—	—	753	753
	\$—	\$—	\$2,199	\$2,199
Mortgage servicing rights	\$—	\$160	\$—	\$160

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral-dependent loans and have specific valuation allowances, had a carrying amount of \$1.7 million and a valuation allowance of \$86,000 at September 30, 2015, compared to a carrying amount of \$4.8 million and a valuation allowance of \$470,000 at December 31, 2014, resulting in a decrease in the provision for loan losses of \$384,000 for the nine months ended September 30, 2015, and an increase in the provision for loan losses of \$345,000 for the nine months ended September 30, 2014.

Other real estate owned ("OREO"), which is carried at the lower of cost or fair value less costs to sell, had a carrying value of \$2.9 million and a valuation allowance of \$1.0 million at September 30, 2015, compared to a carrying value

of \$3.0 million and a valuation allowance of \$803,000 at December 31, 2014. There were \$467,000 of valuation adjustments of OREO recorded for

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6 - FAIR VALUE (continued)

the nine months ended September 30, 2015, and \$392,000 of valuation adjustments of OREO recorded for the nine months ended September 30, 2014.

A pre-tax provision of \$2,000 on our mortgage servicing rights portfolio was included in noninterest income for the nine months ended September 30, 2015, compared to a pre-tax provision of \$6,000 for the same period in 2014.

The following table presents quantitative information, based on certain empirical data with respect to Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at September 30, 2015:

	Fair Value	Valuation Technique(s)	Significant Unobservable Input(s)	Range (Weighted Average)
Impaired loans:				
Multi-family mortgage loans	\$ 230	Sales comparison	Comparison between sales and income approaches	10%
		Income approach	Cap Rate	10%
Nonresidential real estate loans	1,323	Sales comparison	Comparison between sales and income approaches	-25.74% to 1.24% (-21%)
		Income approach	Cap Rate	8.5%
Commercial loans	58	Sales comparison	Discount applied to valuation	34.3%
Impaired loans	\$ 1,611			
Other real estate owned:				
One-to-four family residential real estate	\$ 42	Sales comparison	Discount applied to valuation	-0.35% to 2.8% (0.03%)
Multi-family mortgage	962	Sales comparison	Comparison between sales and income approaches	-67.74% to 11.68% (7%)
Nonresidential real estate loans	107	Sales comparison	Comparison between sales and income approaches	58%
Land	749	Sales comparison	Discount applied to valuation	-7.7% to 17.24% (6%)
Other real estate owned	\$ 1,860			

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6 - FAIR VALUE (continued)

The following table presents quantitative information, based on certain empirical data with respect to Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2014:

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

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6 - FAIR VALUE (continued)

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

	Carrying Amount	Fair Value Measurements at September 30, 2015 Using:			Total
		Level 1	Level 2	Level 3	
Financial assets					
Cash and cash equivalents	\$61,470	\$8,809	\$52,661	\$—	\$61,470
Securities	104,242	512	103,730	—	104,242
Loans receivable, net of allowance for loan losses	1,162,298	—	1,159,706	1,611	1,161,317
FHLBC stock	6,257	—	—	—	N/A
Accrued interest receivable	4,000	—	4,000	—	4,000
Financial liabilities					
Noninterest-bearing demand deposits	\$233,192	\$—	\$233,192	\$—	\$233,192
Savings deposits	152,585	—	152,585	—	152,585
NOW and money market accounts	572,860	—	572,860	—	572,860
Certificates of deposit	222,897	—	222,878	—	222,878
Borrowings	18,048	—	18,049	—	18,049
Accrued interest payable	46	—	46	—	46
		Fair Value Measurements at December 31, 2014 Using:			
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	\$59,581	\$9,693	\$49,888	\$—	\$59,581
Securities	121,174	509	120,665	—	121,174
Loans receivable, net of allowance for loan losses	1,172,356	—	1,166,181	4,344	1,170,525
FHLBC stock	6,257	—	—	—	N/A
Accrued interest receivable	3,926	—	3,926	—	3,926
Financial liabilities					
Noninterest-bearing demand deposits	\$134,129	\$—	\$134,129	\$—	\$134,129
Savings deposits	154,532	—	154,532	—	154,532
NOW and money market accounts	690,193	—	690,193	—	690,193
Certificates of deposit	232,859	—	232,588	—	232,588
Borrowings	12,921	—	12,908	—	12,908
Accrued interest payable	89	—	89	—	89

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

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

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

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

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6 - FAIR VALUE (continued)

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

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

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

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

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

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

NOTE 7 – EQUITY INCENTIVE PLANS

On June 27, 2006, the Company's stockholders approved the BankFinancial Corporation 2006 Equity Incentive Plan, which authorized the Human Resources Committee of the Board of Directors of the Company to grant a variety of cash- and equity-based incentive awards, including stock options, stock appreciation rights, restricted stock, performance shares and other incentive awards, to employees and directors aggregating up to 3,425,275 shares of the Company's common stock.

The Human Resources Committee may grant stock options to purchase shares of the Company's common stock to certain employees and directors of the Company. The exercise price for the stock options is the fair market value of the common stock on the dates of the grants.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. The risk-free interest rate was determined using the yield available on the option grant date for a zero-coupon U.S. Treasury security with a term equivalent to the expected life of the option. The expected life for options granted represents the period the option is expected to be outstanding and was determined by applying the simplified method as allowed by SAB 107. The expected volatility for options issued in 2015 was determined using the Company's historical data. Estimated forfeitures were assumed to be zero due to the lack of historical experience for the Company. On August 10, 2015 the Company awarded a total of 1,215,697 stock options to officers and directors.

The Company estimated the grant date fair value of options awarded in 2015 using Black-Scholes Option-Pricing model with the following assumptions:

	2015 Assumptions	
Risk-free interest rate	0.51	%
Expected option life (years)	1.3	
Expected stock price volatility	18.35	%
Dividend yield	1.33	%

The Company recognized \$280,000 of stock-based compensation expenses relating to the granting of stock options for the three months ended and nine months ended September 30, 2015.

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7 – EQUITY INCENTIVE PLANS (continued)

A summary of the activity in the stock option plan for 2015 follows:

Stock Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value ⁽¹⁾
Stock options outstanding at December 31, 2014	—	\$—		\$—
Stock options granted	1,215,697	11.99		
Stock options exercised	—	—		
Stock options expired	—	—		
Stock options forfeited	—	—		
Stock options outstanding at September 30, 2015	1,215,697	\$11.99	1.7	\$535
Stock options exercisable at September 30, 2015	303,924	\$11.99	1.7	\$134
Fully vested and expected to vest	1,215,697	\$11.99	1.7	\$535

(1) Stock option aggregate intrinsic value represents the number of shares subject to options multiplied by the difference (if positive) in the closing market price of the common stock underlying the options on the date shown and the weighted average exercise price.

The weighted average fair value of the options granted is \$0.92 per option. As of September 30, 2015, there was \$839,000 of total unrecognized compensation cost related to the nonvested stock options granted under the Plan. The cost is expected to be recognized ratably over the remaining three quarterly installments.

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

Cautionary Statement Regarding Forward-Looking Information

Forward Looking Statements

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

Factors that could cause actual results to differ materially from the results anticipated or projected and which could materially and adversely affect our operating results, financial condition or future prospects include, but are not limited to: (i) less than anticipated loan growth due to intense competition for high quality loans and leases, particularly in terms of pricing and credit underwriting, or a dearth of borrowers who meet our underwriting standards; (ii) the impact of re-pricing and competitors' pricing initiatives on loan and deposit products; (iii) interest rate movements and their impact on the economy, customer behavior and our net interest margin; (iv) adverse economic conditions in general and in the Chicago metropolitan area in particular that could result in increased

delinquencies in our loan portfolio or a decline in the value of our investment securities and the collateral for our loans; (v) declines in real estate values that adversely impact the value of our loan collateral, Other Real Estate Owned ("OREO"), asset dispositions and the level of borrower equity in their investments; (vi) borrowers that experience legal or financial difficulties that we do not currently foresee; (vii) results of supervisory monitoring or examinations by regulatory authorities, including the possibility that a regulatory authority could, among other things, require us to increase our allowance for loan losses or adversely change our loan classifications, write-down assets, reduce credit concentrations or maintain specific capital levels; (viii) changes, disruptions or

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illiquidity in national or global financial markets; (ix) the credit risks of lending activities, including risks that could cause changes in the level and direction of loan delinquencies and charge-offs or changes in estimates relating to the computation of our allowance for loan losses; (x) monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board; (xi) factors affecting our ability to access deposits or cost-effective funding, and the impact of competitors' pricing initiatives on our deposit products; (xii) the impact of new legislation or regulatory changes, including the Dodd-Frank Act and Basel III, on our products, services, operations and operating expenses; (xiii) higher federal deposit insurance premiums; (xiv) higher than expected overhead, infrastructure and compliance costs; (xv) changes in accounting principles, policies or guidelines; and (xvi) privacy and cybersecurity risks.

These risks and uncertainties, as well as the Risk Factors set forth in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014, should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. We do not undertake any obligation to update any forward-looking statement in the future, or to reflect circumstances and events that occur after the date on which the forward-looking statement was made.

Critical Accounting Policies

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that the most critical accounting policies upon which our financial condition and results of operation depend, and which involve the most complex subjective decisions or assessments, are included in the discussion entitled "Critical Accounting Policies" in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2014, and all amendments thereto, as filed with the Securities and Exchange Commission.

Overview

Total loans increased modestly due to stronger originations in commercial and industrial loans, partially offset by reduced originations of multi-family loans and commercial leases, as well as loan repayments that resulted in further improvements in our asset quality. Competitive factors continue to intensify in all loan segments. We are encouraged by an increase in loan opportunities in our commercial-related loan segments, but it is becoming more difficult to predict the quantity of new loan originations due to the various competitive factors we encounter. Nevertheless, the combination of our existing loan prospects and continuing marketing efforts provide us reason to believe that our commercial-related loan originations may achieve more meaningful net loan portfolio growth in the remainder of 2015 and into early 2016.

Our average yield on loans declined due to the comparatively lower yields on the floating-rate commercial and industrial loan portfolio, the continued impact of loan renewals at reduced market yields, and loan prepayments on higher-yield loans and leases. Our net interest margin declined principally due to lower yields on our loan portfolio, partially offset by improved yields in the investment securities portfolio and a slightly reduced cost of funds.

Non-interest income increased due primarily to continued higher deposit-account related income. We continued to reduce our core noninterest expense consistent with our expectations for 2015.

Our ratio of nonperforming loans to total loans was 0.57% and our ratio of non-performing assets to total assets was 0.80% at September 30, 2015. Non-performing asset expense increased in the third quarter due in part to collection expenses and due in part to a seasonally higher volume of updated valuations on non-performing assets. As we reduce non-performing assets and non-performing asset expense, we expect to redeploy these resources into additional commercial-related loan originations capacity during the remainder of 2015 and early 2016.

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SELECTED FINANCIAL DATA

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

	September 30, 2015	December 31, 2014	Change
(Dollars in thousands)			
Selected Financial Condition Data:			
Total assets	\$1,431,423	\$1,465,410	\$(33,987)
Loans, net	1,162,298	1,172,356	(10,058)
Securities, at fair value	104,242	121,174	(16,932)
Core deposit intangible	1,441	1,855	(414)
Deposits	1,181,534	1,211,713	(30,179)
Borrowings	18,048	12,921	5,127
Equity	213,074	216,121	(3,047)

	Three Months Ended September 30, 2015			Nine Months Ended September 30, 2015		
	2015	2014	Change	2015	2014	Change
(Dollars in thousands)						
Selected Operating Data:						
Interest and dividend income	\$12,147	\$12,368	\$(221)	\$36,551	\$36,936	\$(385)
Interest expense	699	746	(47)	2,076	2,332	(256)
Net interest income	11,448	11,622	(174)	34,475	34,604	(129)
Provision for (recovery of) loan losses	(956)	(1,413)	457	(2,168)	20	(2,188)
Net interest income after provision for (recovery of) loan losses	12,404	13,035	(631)	36,643	34,584	2,059
Noninterest income	1,709	1,748	(39)	4,934	4,940	(6)
Noninterest expense	10,232	11,157	(925)	30,776	33,510	(2,734)
Income before income tax expense	3,881	3,626	255	10,801	6,014	4,787
Income tax expense	1,532	36	1,496	4,242	78	4,164
Net income	\$2,349	\$3,590	\$(1,241)	\$6,559	\$5,936	\$623

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	Three Months Ended		Nine Months Ended		
	September 30, 2015	2014	September 30, 2015	2014	
Selected Financial Ratios and Other Data:					
Performance Ratios:					
Return on assets (ratio of net income to average total assets) ⁽¹⁾	0.65	% 1.01	% 0.61	% 0.55	%
Return on equity (ratio of net income to average equity) ⁽¹⁾	4.41	7.98	4.06	4.43	
Average equity to average assets	14.85	12.60	14.92	12.42	
Net interest rate spread ⁽¹⁾⁽²⁾	3.33	3.35	3.37	3.34	
Net interest margin ⁽¹⁾⁽³⁾	3.40	3.40	3.43	3.39	
Efficiency ratio ⁽⁴⁾	77.77	83.45	78.09	84.74	
Noninterest expense to average total assets ⁽¹⁾	2.85	3.13	2.84	3.11	
Average interest-earning assets to average interest-bearing liabilities	134.89	123.36	130.22	122.61	
Dividends declared per share	\$0.08	\$0.04	\$0.16	\$0.05	
Dividend payout ratio	69.82	% 23.50	% 50.74	% 17.78	%
			At September 30, 2015	At December 31, 2014	
Asset Quality Ratios:					
Nonperforming assets to total assets ⁽⁵⁾			0.80	% 1.27	%
Nonperforming loans to total loans			0.57	1.03	
Allowance for loan losses to nonperforming loans			150.71	98.17	
Allowance for loan losses to total loans			0.86	1.01	
Capital Ratios:					
Equity to total assets at end of period			14.89	% 14.75	%
Tier 1 leverage ratio (Bank only)			11.27	% 11.45	%
Other Data:					
Number of full-service offices			19	19	
Employees (full-time equivalents)			264	269	

(1) Ratios annualized.

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

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

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

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

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

Total assets decreased \$34.0 million, or 2.3%, to \$1.431 billion at September 30, 2015, from \$1.465 billion at December 31, 2014. The decrease in total assets was primarily due to decreases in securities and loans. Partially offsetting this decrease was a \$1.9 million, or 3.2%, increase in cash and cash equivalents to \$61.5 million at September 30, 2015, from \$59.6 million at December 31, 2014.

Loans decreased \$10.1 million, or 0.9%, to \$1.162 billion at September 30, 2015, from \$1.172 billion at December 31, 2014. At September 30, 2015, our loan portfolio included \$867.0 million of real estate loans, which represented 74.1% of the loan portfolio. The Bank's primary lending area consists of the counties where our branch offices are located, and contiguous counties in the State of Illinois. We derive the most significant portion of our revenues from these geographic areas. We also engage in multi-family lending activities in carefully selected metropolitan areas outside

our primary lending area and engage in certain types of commercial lending and leasing activities on a nationwide basis. At September 30, 2015, \$676.2 million, or 78.0%, of our real estate loans

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were in Illinois, while \$76.6 million, or 8.8%, were in Texas, \$53.2 million, or 6.1%, were in Colorado, and \$21.6 million, or 2.5%, were in Minnesota. This information reflects the location of the collateral for these real estate loans, but does not necessarily reflect the location of the borrower.

Total liabilities decreased by \$30.9 million, or 2.5%, to \$1.218 billion at September 30, 2015, from \$1.249 billion at December 31, 2014, primarily due to decreases in money market and interest-bearing demand accounts and certificates of deposits. These decreases were partially offset by an increase in non-interest bearing demand accounts. Total deposits decreased \$30.2 million, or 2.5%, to \$1.182 billion at September 30, 2015, from \$1.212 billion at December 31, 2014. Noninterest-bearing demand deposits increased \$99.1 million, or 73.9%, to \$233.2 million at September 30, 2015, from \$134.1 million at December 31, 2014. Money market and interest-bearing NOW accounts decreased \$117.3 million, or 17.0%, to \$572.9 million at September 30, 2015, from \$690.2 million at December 31, 2014. Certificates of deposit decreased \$10.0 million, or 4.3%, to \$222.9 million at September 30, 2015, from \$232.9 million at December 31, 2014. Core deposits (savings, money market, noninterest-bearing demand and NOW accounts) were 81.1% and 80.8% of total deposits at September 30, 2015 and December 31, 2014, respectively. The volatility noted in overall transaction account balances is consistent with seasonal fluctuations observed in previous years.

The changes in the balances of noninterest bearing demand deposits and money market and interest-bearing NOW accounts were due in substantial part to efforts we undertook through the third quarter of 2015 to simplify our deposit account options. As part of this process, we discontinued several older account types and converted the discontinued account types to current account types. During the third quarter of 2015, we converted approximately 9,400 older account types, totaling \$80 million, to current account types. Approximately 48% of the converted accounts, or 4,500 accounts, were interest-bearing demand accounts that were converted to non-interest bearing demand accounts. Approximately \$45 million of the accounts that were converted to non-interest bearing account types have balances that could migrate to interest-bearing accounts if interest rates were to increase materially; accordingly, we have incorporated the possibility of such migration into our various interest-rate risk management scenarios.

Borrowings increased \$5.1 million to \$18.0 million at September 30, 2015, from \$12.9 million at December 31, 2014 due to a \$5.0 million increase in outstanding FHLBC advances to \$15.0 million at September 30, 2015, from \$10.0 million at December 31, 2014.

Total stockholders' equity was \$213.1 million at September 30, 2015, compared to \$216.1 million at December 31, 2014. The decrease in total stockholders' equity was primarily due to the combined impact of our repurchase of 600,000 shares of our common stock during the nine months ended September 30, 2015 at a total cost of \$7.4 million, and our declaration and payment of cash dividends totaling \$3.3 million during this period. These items were partially offset by net income of \$6.6 million that we recorded for the nine months ended September 30, 2015. The unallocated shares of common stock that our ESOP owns were reflected as a \$9.5 million reduction to stockholders' equity at September 30, 2015, compared to a \$10.3 million reduction at December 31, 2014.

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

Net Income. We had net income of \$2.3 million and \$3.6 million for the three months ended September 30, 2015 and 2014, respectively. Earnings per basic and fully diluted share of common stock were \$0.12 for the three months ended September 30, 2015, compared to \$0.17 for the three months ended September 30, 2014.

Net Interest Income. Net interest income was \$11.4 million for the three months ended September 30, 2015, compared to \$11.6 million for the three months ended September 30, 2014. The decrease in net interest income reflected a \$221,000, or 1.8%, decrease in interest income, partially offset by a \$47,000, or 6.3%, decrease in interest expense. The decrease in net interest income was primarily attributable to decreases in the yield on interest-earning assets and net average interest-earning assets. Total average interest-earning assets decreased \$19.0 million, or 1.40%, to \$1.336 billion for the three months ended September 30, 2015, from \$1.355 billion for the same period in 2014. Our net interest rate spread decreased by two basis point to 3.33% for the three months ended September 30, 2015, from 3.35% for the same period in 2014. Our net interest margin remained at 3.40% for the three months ended September 30, 2015 and 2014. The yield on interest-earning assets decreased one basis point to 3.61% for the three months ended September 30, 2015, from 3.62% for the same period in 2014, and the cost of interest-bearing liabilities

increased one basis point to 0.28% for the three months ended September 30, 2015, from 0.27% for the same period in 2014.

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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 and purchase accounting adjustments that are amortized or accreted to interest income or expense.

	For the Three Months Ended September 30,						
	2015			2014			
	Average			Average			
	Outstanding	Interest	Yield/Rate ⁽¹⁾	Outstanding	Interest	Yield/Rate ⁽¹⁾	
	Balance			Balance			
	(Dollars in thousands)						
Interest-earning assets:							
Loans	\$ 1,164,251	\$ 11,792	4.02	% \$ 1,127,735	\$ 11,983	4.22	%
Securities	102,578	267	1.03	114,805	283	0.98	
Stock in FHLBC	6,257	7	0.44	6,257	8	0.51	
Other	63,326	81	0.51	106,639	94	0.35	
Total interest-earning assets	1,336,412	12,147	3.61	1,355,436	12,368	3.62	
Noninterest-earning assets	98,337			72,114			
Total assets	\$ 1,434,749			\$ 1,427,550			
Interest-bearing liabilities:							
Savings deposits	\$ 154,413	41	0.11	\$ 153,256	40	0.10	
Money market accounts	333,613	261	0.31	348,410	281	0.32	
NOW accounts	270,175	92	0.14	346,204	89	0.10	
Certificates of deposit	223,432	301	0.53	247,672	334	0.54	
Total deposits	981,633	695	0.28	1,095,542	744	0.27	
Borrowings	9,100	4	0.17	3,185	2	0.25	
Total interest-bearing liabilities	990,733	699	0.28	1,098,727	746	0.27	
Noninterest-bearing deposits	211,438			131,626			
Noninterest-bearing liabilities	19,517			17,268			
Total liabilities	1,221,688			1,247,621			
Equity	213,061			179,929			
Total liabilities and equity	\$ 1,434,749			\$ 1,427,550			
Net interest income		\$ 11,448			\$ 11,622		
Net interest rate spread ⁽²⁾			3.33	%		3.35	%
Net interest-earning assets ⁽³⁾	\$ 345,679			\$ 256,709			
Net interest margin ⁽⁴⁾			3.40	%		3.40	%
Ratio of interest-earning assets to interest-bearing liabilities	134.89	%		123.36	%		

(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 (Recovery of) Loan Losses

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

We had a recovery of loan losses of \$956,000 for the three months ended September 30, 2015, compared to a recovery of \$1.4 million for the same period in 2014. The provision for or recovery of loan losses is a function of the allowance for loan loss methodology that we use to determine the appropriate level of the allowance for inherent loan losses after net charge-offs have been deducted. The portion of the allowance for loan losses attributable to loans collectively evaluated for impairment decreased \$750,000, or 7.0%, to \$10.0 million at September 30, 2015, from \$10.7 million at June 30, 2015. The reserve established for loans individually evaluated for impairment increased \$21,000, or 32.3%, to \$86,000 at September 30, 2015, from \$65,000 at June 30, 2015. Net recoveries were \$227,000 for the three months ended September 30, 2015. The allowance for loan losses as a percentage of nonperforming loans was 150.71% at September 30, 2015, compared to 124.86% at June 30, 2015.

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		Change
	2015	2014	
	September 30,		
	(Dollars in thousands)		
Deposit service charges and fees	\$562	\$527	\$35
Other fee income	502	563	(61)
Insurance commissions and annuities income	68	106	(38)
Gain on sale of loans, net	37	39	(2)
Loan servicing fees	85	102	(17)
Amortization of servicing assets	(35)	(36)	1
Recovery (impairment) of servicing assets	(15)	4	(19)
Earnings on bank owned life insurance	48	57	(9)
Trust income	172	171	1
Other	285	215	70
Total noninterest income	\$1,709	\$1,748	\$(39)

Noninterest income totaled \$1.7 million for the three months ended September 30, 2015 and for the three months ended September 30, 2014. Deposit service charges and fees increased \$35,000 and other fee income decreased \$61,000 for the three months ended September 30, 2015. Noninterest income for the three months ended September 30, 2015 included a \$37,000 gain on sale of loans, compared to a \$39,000 gain on sale of loans that was recorded for the same period in 2014. Earnings on bank owned life insurance decreased \$9,000 for the three months ended September 30, 2015 to \$48,000, from \$57,000 for the same period in 2014.

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Noninterest Expense

	Three Months Ended September 30,		Change
	2015	2014	
	(Dollars in thousands)		
Compensation and benefits	\$5,329	\$5,492	\$(163)
Office occupancy and equipment	1,537	1,687	(150)
Advertising and public relations	212	272	(60)
Information technology	686	674	12)
Supplies, telephone and postage	393	394	(1)
Amortization of intangibles	136	143	(7)
Nonperforming asset management	244	418	(174)
Gain (loss) on sale other real estate owned	(11)	52	(63)
Valuation adjustments of other real estate owned	231	315	(84)
Operations of other real estate owned	114	127	(13)
FDIC insurance premiums	202	208	(6)
Other	1,159	1,375	(216)
Total noninterest expense	\$10,232	\$11,157	\$(925)

Noninterest expense decreased by \$925,000, or 8.3%, to \$10.2 million for the three months ended September 30, 2015, from \$11.2 million for the same period in 2014, due in substantial part to decreases in compensation and benefits expense, and expense for nonperforming asset management and other real estate owned. Total compensation and benefit expense for the three months ended September 30, 2015 decreased \$163,000, or 3.0%, primarily due to a reduction in full-time equivalent employees to 264 at September 30, 2015, from 270 at September 30, 2014, which was partially offset by \$280,000 in stock option expense for the three months ended September 30, 2015.

Nonperforming asset management expense decreased \$174,000 or 41.6%, to \$244,000 for the three months ended September 30, 2015, compared to \$418,000 for the same period in 2014. OREO expense decreased \$160,000, or 32.4%, to \$334,000 for the three months ended September 30, 2015, from \$494,000 for the three months ended September 30, 2014. OREO expense for the three months ended September 30, 2015 included gain on sale of OREO \$11,000, compared to a loss of \$52,000 for the three months ended September 30, 2014.

Income Taxes

For the three months ended September 30, 2015, we recorded income tax expense of \$1.5 million, compared to \$36,000 for the three months ended September 30, 2014. Our effective tax rate for the three months ended September 30, 2015 was 39.5%. For the three months ended September 30, 2014, income tax expense consisted solely of expense for state taxes.

Operating results for the nine months ended September 30, 2015 and 2014

Net Income. We had net income of \$6.6 million for the nine months ended September 30, 2015, compared to \$5.9 million for the nine months ended September 30, 2014. Our earnings per basic and fully diluted share of common stock were \$0.33 for the nine months ended September 30, 2015, and \$0.29 per basic and fully diluted share for the same period in 2014.

Net Interest Income. Net interest income was \$34.5 million for the nine months ended September 30, 2015, compared to \$34.6 million for the nine months ended September 30, 2014. A \$385,000 decrease in interest income was partially offset by a \$256,000 decrease in interest expense.

Total average interest-earning assets decreased \$21.7 million, or 1.6%, to \$1.343 billion for the nine months ended September 30, 2015, from \$1.364 billion for the same period in 2014. Our net interest rate spread increased by three basis points to 3.37% for the nine months ended September 30, 2015, from 3.34% for the same period in 2014. Our net interest margin increased by four basis points to 3.43% for the nine months ended September 30, 2015, from 3.39% for the same period in 2014. The increase in the net interest spread and net interest margin was primarily a result of increased yield on interest-earning assets, which was partially offset by a lower cost of funds. The yield on

interest-earning assets increased two basis points to 3.64% for the nine

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months ended September 30, 2015, from 3.62% for the same period in 2014, and the cost of interest-bearing liabilities decreased one basis point to 0.27% for the nine months ended September 30, 2015, from 0.28% for the same period in 2014.

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 Nine Months Ended September 30, 2015			2014			
	Average Outstanding Balance (Dollars in thousands)	Interest	Yield/Rate ⁽¹⁾	Average Outstanding Balance	Interest	Yield/Rate ⁽¹⁾	
Interest-earning assets:							
Loans	\$ 1,159,592	\$ 35,451	4.09 %	\$ 1,120,523	\$ 35,767	4.27 %	
Securities	110,674	851	1.03	114,194	866	1.01	
Stock in FHLBC	6,257	23	0.49	6,184	20	0.43	
Other	66,110	226	0.46	123,406	283	0.31	
Total interest-earning assets	1,342,633	36,551	3.64	1,364,307	36,936	3.62	
Noninterest-earning assets	101,597			73,946			
Total assets	\$ 1,444,230			\$ 1,438,253			
Interest-bearing liabilities:							
Savings deposits	\$ 156,189	122	0.10	\$ 153,818	118	0.10	
Money market accounts	337,828	797	0.32	349,146	842	0.32	
NOW accounts	304,020	270	0.12	349,116	265	0.10	
Certificates of deposit	227,905	879	0.52	257,799	1,102	0.57	
Total deposits	1,025,942	2,068	0.27	1,109,879	2,327	0.28	
Borrowings	5,070	8	0.21	2,808	5	0.24	
Total interest-bearing liabilities	1,031,012	2,076	0.27	1,112,687	2,332	0.28	
Noninterest-bearing deposits	176,112			128,422			
Noninterest-bearing liabilities	21,582			18,555			
Total liabilities	1,228,706			1,259,664			
Equity	215,524			178,589			
Total liabilities and equity	\$ 1,444,230			\$ 1,438,253			
Net interest income		\$ 34,475			\$ 34,604		
Net interest rate spread ⁽²⁾			3.37 %			3.34 %	
Net interest-earning assets ⁽³⁾	\$ 311,621			\$ 251,620			
Net interest margin ⁽⁴⁾			3.43 %			3.39 %	

Ratio of interest-earning
assets to interest-bearing liabilities 130.22 % 122.61 %

(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 (Recovery of) Loan Losses

We recorded a recovery of loan losses of \$2.2 million for the nine months ended September 30, 2015, compared to a provision for loan losses of \$20,000 for the same period in 2014. The portion of the allowance for loan losses attributable to loans collectively evaluated for impairment decreased \$1.5 million, or 13.2%, to \$10.0 million at September 30, 2015, from \$11.5 million at December 31, 2014. The reserve established for loans individually evaluated for impairment decreased \$384,000 for the nine months ended September 30, 2015. Net recoveries of \$259,000 were recorded for the nine months ended September 30, 2015, compared to charge-offs of \$1.1 million for the nine months ended September 30, 2014. The allowance for loan losses as a percentage of nonperforming loans was 150.71% at September 30, 2015, compared to 98.17% at December 31, 2014.

Noninterest Income

	Nine Months Ended		Change
	September 30, 2015	2014	
	(Dollars in thousands)		
Deposit service charges and fees	\$1,493	\$1,438	\$55
Other fee income	1,638	1,677	(39)
Insurance commissions and annuities income	217	279	(62)
Gain on sale of loans, net	92	107	(15)
Loss on sales of securities	—	(7)	7)
Gain (loss) on disposition of premises and equipment	(1)	5)	(6)
Loan servicing fees	271	310	(39)
Amortization of servicing assets	(105)	(106)	1)
Impairment of servicing assets	(2)	(6)	4)
Earnings on bank owned life insurance	142	182	(40)
Trust income	529	505	24
Other	660	556	104
Total noninterest income	\$4,934	\$4,940	\$(6)

Noninterest income was \$4.9 million for the nine months ended September 30, 2015 and 2014. Deposit service charges and fees increased \$55,000 and other fee income decreased \$39,000 for the nine months ended September 30, 2015. Noninterest income for the nine months ended September 30, 2015 included a \$92,000 gain on sale of loans, compared to a \$107,000 gain on sale of loans that was recorded for the same period in 2014. Earnings on bank owned life insurance decreased \$40,000 for the nine months ended September 30, 2015 to \$142,000, from \$182,000 for the nine months ended September 30, 2014.

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Noninterest Expense

	Nine Months Ended September 30,		Change
	2015	2014	
	(Dollars in thousands)		
Compensation and benefits	\$16,188	\$17,046	\$(858)
Office occupancy and equipment	4,902	5,227	(325)
Advertising and public relations	783	741	42
Information technology	1,982	2,004	(22)
Supplies, telephone and postage	1,189	1,169	20
Amortization of intangibles	414	435	(21)
Nonperforming asset management	442	619	(177)
Gain on sale other real estate owned	(91)	(40)	(51)
Valuation adjustments of other real estate owned	467	392	75
Operations of other real estate owned	404	808	(404)
FDIC insurance premiums	699	1,157	(458)
Other	3,397	3,952	(555)
Total noninterest expense	\$30,776	\$33,510	\$(2,734)

Noninterest expense decreased by \$2.7 million, or 8.2%, to \$30.8 million for the nine months ended September 30, 2015, from \$33.5 million for the nine months ended September 30, 2014. Total compensation and benefit expense for the nine months ended September 30, 2015 decreased \$858,000, or 5.0%, primarily due to a reduction in full-time equivalent employees to 264 at September 30, 2015, from 269 at December 31, 2014 and 270 at September 30, 2014, which was partially offset by \$280,000 in stock option expense for the nine months ended September 30, 2015.

Noninterest expense for the nine months ended September 30, 2015 included \$1.2 million of nonperforming asset management and OREO expense, compared to \$1.8 million of nonperforming asset management and OREO expense for the same period in 2014. Nonperforming asset management and OREO expenses decreased \$557,000, or 31.3% for the nine months ended September 30, 2015, primarily due to a decline in nonperforming assets and OREO properties, a decline in expenses relating to resolutions and accelerated dispositions of nonperforming assets, and a \$200,000 reimbursement that we received for legal, receivership and other expenses in connection with the final resolution of certain loans. Noninterest expense for the nine months ended September 30, 2015 included a \$467,000 valuation adjustment to OREO properties, compared to a \$392,000 valuation adjustment to OREO properties for the same period in 2014. The OREO valuation adjustments were based on updated appraisals. OREO expense decreased \$404,000, or 50.0%, to \$404,000 for the nine months ended September 30, 2015, compared to \$808,000 for the nine months ended September 30, 2014. OREO expense for the nine months ended September 30, 2014 included a \$140,000 litigation settlement payment concerning a purchased impaired OREO property.

Income Taxes

For the nine months ended September 30, 2015, we recorded income tax expense of \$4.2 million, compared to \$78,000 for the nine months ended September 30, 2014. Our effective tax rate for the nine months ended September 30, 2015 was 39.3%. For the nine months ended September 30, 2014, income tax expense consisted solely of expense for state taxes.

Nonperforming Loans and Assets

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

loan classification unless: (1) the loan is repaid in full shortly after the period end date; (2) the loan is well secured and there are no asserted or pending legal barriers to its collection; or (3) the borrower has remitted all scheduled payments and is otherwise in substantial compliance with the terms of the loan, but the processing of loan payments actually

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received or the renewal of the loan has not occurred for administrative reasons. At September 30, 2015, we had no loans in this category.

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

As part of the asset classification process, we develop an exit strategy for real estate collateral or OREO by assessing overall market conditions, the current use and condition of the asset, and its highest and best use. For most income-producing real estate, we believe that investors value most highly a stable income stream from the asset; consequently, we perform a comparative evaluation to determine whether conducting a sale on an “as-is”, “as-stabilized” or “as-completed” basis is most likely to produce the highest net realizable value. If we determine that the “as-stabilized” or “as-completed” basis is appropriate, we then complete the necessary improvements or tenant stabilization tasks, with the applicable time value discount and improvement expenses incorporated into our estimates of the expected costs to sell. As of September 30, 2015, substantially all impaired real estate loan collateral and OREO were valued on an “as-is” basis.

Estimates of the net realizable value of real estate collateral also include a deduction for the expected costs to sell the collateral or such other deductions from the cash flows resulting from the operation and liquidation of the asset as are appropriate. For most real estate collateral subject to the judicial foreclosure process, we generally apply a 10.0% deduction to the value of the asset to determine the expected costs to sell the asset. This estimate includes one year of real estate taxes, sales commissions and miscellaneous repair and closing costs. If we receive a purchase offer that requires unbudgeted repairs, or if the expected resolution period for the asset exceeds one year, we then include, on a case-by-case basis, the costs of the additional real estate taxes and repairs and any other material holding costs in the expected costs to sell the collateral. For OREO, we generally apply a 7.0% deduction to determine the expected costs to sell, as expenses for real estate taxes and repairs are expensed when incurred.

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Nonperforming Assets Summary

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

	September 30, 2015	June 30, 2015	December 31, 2014	Quarter Change	Nine Month Change
	(Dollars in thousands)				
Nonaccrual loans:					
One-to-four family residential	\$2,952	\$3,468	\$4,408	\$(516)	\$(1,456)
Multi-family mortgage	1,399	2,382	4,481	(983)	(3,082)
Nonresidential real estate	2,263	2,732	3,245	(469)	(982)
Commercial	75	75	76	—	(1)
Consumer	—	1	3	(1)	(3)
	6,689	8,658	12,213	(1,969)	(5,524)
Other real estate owned:					
One-to-four family residential	325	471	806	(146)	(481)
Multi-family mortgage	1,474	2,018	2,307	(544)	(833)
Nonresidential real estate	1,289	1,240	885	49	404
Land	51	51	135	—	(84)
	3,139	3,780	4,133	(641)	(994)
Nonperforming assets (excluding purchased other real estate owned)	9,828	12,438	16,346	(2,610)	(6,518)
Purchased other real estate owned:					
One-to-four family residential	—	—	457	—	(457)
Land	1,670	1,759	1,768	(89)	(98)
	1,670	1,759	2,225	(89)	(555)
Total nonperforming assets	\$11,498	\$14,197	\$18,571	\$(2,699)	\$(7,073)
Ratios:					
Nonperforming loans to total loans	0.57	% 0.74	% 1.03	%	
Nonperforming assets to total assets	0.80	0.99	1.27		
Nonperforming assets to total assets ⁽¹⁾	0.69	0.86	1.11		

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

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Nonperforming Assets

Nonperforming assets totaled \$11.5 million at September 30, 2015, \$14.2 million at June 30, 2015, and \$18.6 million at December 31, 2014. Nonperforming assets decreased \$2.7 million and \$7.1 million, respectively, for the three and nine months ended September 30, 2015. Although we experience occasional isolated instances of new non-accrual loans, we believe that continuing our aggressive resolution posture will maintain the trends favoring very strong asset quality.

We assigned a Special Mention risk rating to loans to a single commercial borrower with a total combined balance of \$16.5 million collateralized primarily with real estate assets with a recently appraised value of approximately \$25.3 million as of September 30, 2015. The borrower operates a multi-store retail business in the Chicago metropolitan area. To maintain competitiveness and profitability, the borrower relocated or closed several underperforming stores and a warehouse, and as a result, owns five real estate parcels that are now non-essential to the borrower's core business. Some parcels are now fully or partially leased, but expenses associated with the discontinued operations have adversely impacted the borrower's operating results as presented in the audited consolidated financial statements that we receive from the borrower annually, as well as the borrower's cash flow. We are monitoring the borrower's financial performance and the status of the process the borrower has initiated to sell certain of the non-core real estate assets. If the borrower manages the cash flow from its core business appropriately through the seasonal fluctuations that are inherent to its industry and successfully implements its non-core asset disposition plans, we believe that the borrower's financial performance can improve significantly. However, further adverse developments in the core business or material delays in the disposition of non-core assets may require us to take further action.

We continue to experience modest quantities of defaults on residential real estate loans principally due either to the borrower's personal financial condition or deteriorated collateral value.

Other Real Estate Owned

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

The following tables represent the roll-forward of OREO and the composition of OREO properties:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Beginning balance	\$5,539	\$7,704	\$6,358	\$6,306
New foreclosed properties	147	376	1,314	3,836
Payments received	—	—	—	(10)
Valuation adjustments	(231)	(315)	(467)	(392)
Gain (loss) on sale of other real estate owned	11	(52)	91	40
Proceeds from sales of other real estate owned	(657)	(1,723)	(2,487)	(3,790)
Ending balance	\$4,809	\$5,990	\$4,809	\$5,990

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	September 30, 2015	December 31, 2014
	(Dollars in thousands)	
One-to-four family residential	\$325	\$806
Multi-family mortgage	1,474	2,307
Nonresidential real estate	1,289	885
Land	51	135
	3,139	4,133
Acquired other real estate owned:		
One-to-four family residential	—	457
Land	1,670	1,768
	1,670	2,225
Total other real estate owned	\$4,809	\$6,358

Liquidity and Capital Resources

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

Our primary sources of funds are deposits, principal and interest payments on loans and securities, and, to a lesser extent, wholesale borrowings, the proceeds from maturing securities and short-term investments, and the proceeds from the sales of loans and securities and lease payments. The scheduled amortization of loans and securities, as well as proceeds from borrowings, are predictable sources of funds. Other funding sources, however, such as deposit inflows, mortgage prepayments and mortgage loan sales are greatly influenced by market interest rates, economic conditions and competition. We anticipate that we will have sufficient funds available to meet current loan commitments and lines of credit and maturing certificates of deposit that are not renewed or extended. We generally remain fully invested and utilize additional sources of funds through FHLBC advances. We had outstanding FHLBC advances of \$15 million at September 30, 2015.

The liquidity needs of the Company on an unconsolidated basis consist primarily of operating expenses, dividends to stockholders and stock repurchases. The primary source of liquidity for the Company as of September 30, 2015 was \$16.6 million in cash and cash equivalents, and potential future cash dividends from the Bank.

As of September 30, 2015, we were not aware of any known trends, events or uncertainties that had or were reasonably likely to have a material impact on our liquidity. As of September 30, 2015, we had no other material commitments for capital expenditures.

Capital Management

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

We are subject to minimum risk-based capital limitations as set forth by federal banking regulations at both the consolidated Company level and the Bank level. Under the risk-based capital guidelines, different categories of assets, including certain off-balance sheet items, such as loan commitments and letters of credit, are assigned different risk weights, based generally on the perceived credit risk of the asset. These risk weights are multiplied by corresponding asset balances to determine a "risk-weighted" asset base. For purposes of the risk-based capital guidelines, total capital is defined as the sum of "Common Equity Tier 1", "Additional Tier 1" and "Tier 2" capital elements. Common Equity Tier 1 is comprised of common stock, related surplus and

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retained earnings. Additional Tier 1 capital includes, with certain restrictions, noncumulative perpetual preferred stock, certain grandfathered regulatory capital instruments and minority interests in consolidated subsidiaries. Tier 2 capital includes, with certain limitations, perpetual preferred stock not included in Tier 1 capital, subordinate debt, certain maturing capital instruments, and the allowance for loan and credit losses.

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

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

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

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

	Risk-based		Leverage		
	Common Tier	Tier 1	Total Capital	Tier 1	
	1				
Company					
Regulatory capital	\$189,216	\$189,216	\$199,302	\$189,216	
Well-capitalized requirement	67,818	83,468	104,335	70,575	
Regulatory capital - excess	\$121,398	\$105,748	\$94,967	\$118,641	
Capital	18.14	% 18.14	% 19.10	% 13.41	%
Minimum capital requirement	4.50	% 6.00	% 8.00	% 4.00	%
Well capitalized requirement ⁽¹⁾	6.50	% 8.00	% 10.00	% 5.00	%
Bank					
Regulatory capital	159,118	159,118	169,204	159,118	
Well-capitalized requirement	67,804	83,451	104,314	70,588	
Regulatory capital - excess	\$91,314	\$75,667	\$64,890	\$88,530	
Capital	15.25	% 15.25	% 16.22	% 11.27	%
Minimum capital requirement	4.50	% 6.00	% 8.00	% 4.00	%
Well capitalized requirement ⁽¹⁾	6.50	% 8.00	% 10.00	% 5.00	%

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

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

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

Capital Management - Company Total stockholders' equity was \$213.1 million at September 30, 2015, compared to \$216.1 million at December 31, 2014. The decrease in total stockholders' equity was primarily due to the combined impact of our repurchase of 600,000 shares of our common stock during the nine months ended September 30, 2015 at a total cost of \$7.4 million, and our declaration and payment of cash dividends totaling \$3.3 million during this period. These items were partially offset by net income of \$6.6 million that we recorded for the nine months ended September 30, 2015. The unallocated shares of common stock that our ESOP owns were reflected as a \$9.5 million reduction to stockholders' equity at September 30, 2015, compared to a \$10.3 million reduction at December 31, 2014. Cash Dividends. We declared cash dividends of \$0.16 per share for the nine months ended September 30, 2015, compared to a cash dividend of \$0.05 per share for the nine months ended September 30, 2014.

Stock Repurchase Program. On March 30, 2015, the Company announced that its Board had authorized the repurchase of up to 1,055,098 shares of the Company's common stock, which represents approximately 5% of the Company's issued and outstanding shares of common stock. The authorization will expire on December 31, 2015 unless extended by the Board. As of September 30, 2015, the Company had repurchased 600,000 shares of its common stock out of the 1,055,098 that had been authorized for repurchase in 2015. Since its inception, the Company has repurchased 4,839,134 shares of its common stock.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

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

The general objective of our interest rate risk management is to determine the appropriate level of risk given our business strategy and then manage that risk in a manner that is consistent with our policy to reduce, to the extent possible, the exposure of our net interest income to changes in market interest rates. Our Asset/Liability Management Committee ("ALCO"), which consists of certain members of senior management, evaluates the interest rate risk inherent in certain assets and liabilities, our operating environment and capital and liquidity requirements, and modifies our lending, investing and deposit gathering strategies accordingly. The Board of Directors' Asset/Liability Management Committee then reviews the ALCO's activities and strategies, the effect of those strategies on our net interest margin, and the effect that changes in market interest rates would have on the economic value of our loan and securities portfolios as well as the intrinsic value of our deposits and borrowings, and reports to the full Board of Directors.

We actively evaluate interest rate risk in connection with our lending, investing and deposit activities. In an effort to better manage interest-rate risk, we have de-emphasized the origination of residential mortgage loans, and have increased our emphasis on the origination of nonresidential real estate loans, multi-family mortgage loans, commercial

loans and commercial leases. In addition, depending on market interest rates and our capital and liquidity position, we generally sell all or a portion of our longer-term, fixed-rate residential loans, usually on a servicing-retained basis. Further, we primarily invest in shorter-duration securities, which generally have lower yields compared to longer-term investments. Shortening the average maturity of our interest-earning assets by increasing our investments in shorter-term loans and securities, as well as loans with variable rates of interest, helps to better match the maturities and interest rates of our assets and liabilities, thereby reducing the exposure of our net interest income to changes in market interest rates. Finally, we have classified all of our investment portfolio as available-for-sale so as to provide flexibility in liquidity management.

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

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

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

Quantitative Analysis. The following table sets forth, as of September 30, 2015, the estimated changes in the Bank's NPV and net interest income that would result from the designated instantaneous parallel shift in the U.S. Treasury yield curve. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

Change in Interest Rates (basis points)	Estimated Decrease in NPV		Increase (Decrease) in Estimated Net Interest Income	
	Amount (dollars in thousands)	Percent	Amount	Percent
+400	\$(34,662)	(15.76)%	\$(573)	(1.26)%
+300	(24,307)	(11.05)	(356)	(0.78)
+200	(15,763)	(7.17)	(71)	(0.16)
+100	(1,118)	(0.51)	20	0.04
0	—	—	—	—

The Company has opted not to include an estimate for a decrease in rates at September 30, 2015 as the results are not considered relevant given the current targeted fed funds rate of the Federal Open Market Committee. The table set forth above indicates that at September 30, 2015, in the event of an immediate 200 basis point increase in interest rates, the Bank would be expected to experience an 7.17% decrease in NPV and a \$71,000 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. Because of the shortcomings mentioned above, management considers many additional factors such as projected changes in loan and deposit balances and various projected forward interest rate scenarios when evaluating strategies for managing interest rate risk. Accordingly, although the NPV and net interest income table provides an indication of our sensitivity to interest rate changes at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on our net interest income and will differ from actual results.

ITEM 4. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chairman, Chief Executive Officer and President and the Executive Vice President and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of September 30, 2015. Based on that evaluation, the Company's

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management, including the Chairman, President, and Chief Executive Officer and the Executive Vice President and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective. During the quarter ended September 30, 2015, there have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

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

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

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

(b) Use of Proceeds. Not applicable

(c) Repurchases of Equity Securities.

On March 30, 2015, the Company announced that its Board had authorized the repurchase of up to 1,055,098 shares of the Company's common stock. In accordance with this authorization, we have repurchased 600,000 shares of our common stock as of September 30, 2015. There were no share repurchases conducted in the third quarter of 2015. The authorization will expire on December 31, 2015 unless extended by the Board.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number Description

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*

101 The following financial statements from the BankFinancial Corporation Quarterly Report on Form 10-Q for the quarter ended September 30, 2015, formatted in Extensive Business Reporting Language (XBRL): (i) consolidated statement of conditions, (ii) consolidated statements of operations, (iii) consolidated statements of comprehensive income, (iv) consolidated statements of changes in stockholder's equity, (v) consolidated statements of cash flows and (vi) the notes to consolidated financial statements.

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

SIGNATURES

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

BANKFINANCIAL CORPORATION

Dated: October 28, 2015

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

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