

BankFinancial CORP
Form 10-Q
August 01, 2016

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

FORM 10-Q

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

For the Quarterly Period ended June 30, 2016

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 75-3199276
(State or Other Jurisdiction (I.R.S. Employer
of Incorporation) Identification No.)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

Indicate the number of shares outstanding of each of the Issuer's classes of common stock as of the latest practicable date. At July 29, 2016, there were 19,542,026 shares of Common Stock, \$0.01 par value, outstanding.



BANKFINANCIAL CORPORATION

Form 10-Q

June 30, 2016

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

	June 30, 2016	December 31, 2015
Assets		
Cash and due from other financial institutions	\$ 11,509	\$ 13,192
Interest-bearing deposits in other financial institutions	74,048	46,185
Cash and cash equivalents	85,557	59,377
Securities, at fair value	105,698	114,753
Loans receivable, net of allowance for loan losses: June 30, 2016, \$8,915 and December 31, 2015, \$9,691	1,207,553	1,232,257
Other real estate owned, net	5,373	7,011
Stock in Federal Home Loan Bank, at cost	6,257	6,257
Premises and equipment, net	32,021	32,726
Accrued interest receivable	4,000	4,226
Core deposit intangible	1,040	1,305
Bank owned life insurance	22,484	22,387
Deferred taxes	25,187	26,695
Other assets	4,661	5,449
Total assets	\$ 1,499,831	\$ 1,512,443
Liabilities		
Deposits		
Noninterest-bearing	\$ 231,928	\$ 254,830
Interest-bearing	1,036,674	958,089
Total deposits	1,268,602	1,212,919
Borrowings	1,469	64,318
Advance payments by borrowers for taxes and insurance	12,421	11,528
Accrued interest payable and other liabilities	10,632	11,314
Total liabilities	1,293,124	1,300,079
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; 19,678,697 shares issued at June 30, 2016 and 20,297,317 issued at December 31, 2015	197	203
Additional paid-in capital	177,995	184,797
Retained earnings	36,845	36,114
Unearned Employee Stock Ownership Plan shares	(8,811) (9,297
Accumulated other comprehensive income	481	547
Total stockholders' equity	206,707	212,364
Total liabilities and stockholders' equity	\$ 1,499,831	\$ 1,512,443

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		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Interest and dividend income				
Loans, including fees	\$12,099	\$11,836	\$24,446	\$23,659
Securities	307	257	621	584
Other	175	100	273	161
Total interest income	12,581	12,193	25,340	24,404
Interest expense				
Deposits	950	689	1,737	1,373
Borrowings	2	2	71	4
Total interest expense	952	691	1,808	1,377
Net interest income	11,629	11,502	23,532	23,027
Provision for (recovery of) loan losses	1,315	(488)	825	(1,212)
Net interest income after provision for (recovery of) loan losses	10,314	11,990	22,707	24,239
Noninterest income				
Deposit service charges and fees	541	532	1,108	997
Other fee income	505	601	1,000	1,136
Insurance commissions and annuities income	72	86	127	149
Gain on sale of loans, net	3	28	21	55
Gain on sale of securities (includes \$46 accumulated other comprehensive income reclassifications for unrealized net gains on available for sale securities for the six months ended June 30, 2016)	—	—	46	—
Loss on disposition of premises and equipment, net	—	(1)	—	(1)
Loan servicing fees	75	96	148	186
Amortization and impairment of servicing assets	(37)	(32)	(68)	(57)
Earnings on bank owned life insurance	46	45	97	94
Trust income	165	183	325	357
Other	167	151	327	309
Total noninterest income	1,537	1,689	3,131	3,225
Noninterest expense				
Compensation and benefits	5,713	5,278	11,706	10,859
Office occupancy and equipment	1,635	1,670	3,282	3,365
Advertising and public relations	252	227	474	571
Information technology	699	657	1,423	1,296
Supplies, telephone, and postage	297	385	673	796
Amortization of intangibles	129	136	265	278
Nonperforming asset management	127	108	211	198
Operations of other real estate owned	149	92	525	446
FDIC insurance premiums	236	262	453	497
Other	1,269	1,216	2,424	2,238
Total noninterest expense	10,506	10,031	21,436	20,544
Income before income taxes	1,345	3,648	4,402	6,920
Income tax expense	514	1,424	1,667	2,710
Net income	\$831	\$2,224	\$2,735	\$4,210

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Basic earnings per common share	\$0.04	\$ 0.11	\$0.14	\$ 0.21
Diluted earnings per common share	\$0.04	\$ 0.11	\$0.14	\$ 0.21
Weighted average common shares outstanding	19,130,111	20,009,358	19,279,330	20,138,045
Diluted weighted average common shares outstanding	19,130,432	20,013,573	19,279,642	20,142,205

See accompanying notes to the consolidated financial statements.

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

	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Net income	\$831	\$2,224	\$2,735	\$4,210
Unrealized holding loss arising during the period	(40)	(128)	(62)	(210)
Tax effect, included in income tax expense	16	50	24	80
Unrealized holding loss arising during the period, net of tax	(24)	(78)	(38)	(130)
Reclassification adjustment for gain included in net income	—	—	(46)	—
Tax effect, included in income tax expense	—	—	18	—
Reclassification adjustment for gain included in net income, net of tax	—	—	(28)	—
Other comprehensive loss	(24)	(78)	(66)	(130)
Comprehensive income	\$807	\$2,146	\$2,669	\$4,080

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	Unearned Employee Stock Ownership Plan Shares	Accumulated Other Comprehen-sive Income	Total
	\$ 211	\$ 193,845	\$ 31,584	\$(10,276)	\$ 757	\$ 216,121
Net income	—	—	4,210	—	—	4,210
Other comprehensive loss, net of tax	—	—	—	—	(130)	(130)
Repurchase and retirement of common stock (600,000 shares)	(6)	(7,382)	—	—	—	(7,388)
Nonvested stock awards-stock-based compensation expense	—	52	—	—	—	52
Cash dividends declared on common stock (\$0.08 per share)	—	—	(1,688)	—	—	(1,688)
ESOP shares earned	—	86	—	485	—	571
Balance at June 30, 2015	\$ 205	\$ 186,601	\$ 34,106	\$(9,791)	\$ 627	\$ 211,748
Balance at January 1, 2016	\$ 203	\$ 184,797	\$ 36,114	\$(9,297)	\$ 547	\$ 212,364
Net income	—	—	2,735	—	—	2,735
Other comprehensive loss, net of tax	—	—	—	—	(66)	(66)
Repurchase and retirement of common stock (618,620 shares)	(6)	(7,667)	—	—	—	(7,673)
Nonvested stock awards-stock-based compensation expense	—	768	—	—	—	768
Cash dividends declared on common stock (\$0.10 per share)	—	—	(2,004)	—	—	(2,004)
ESOP shares earned	—	97	—	486	—	583
Balance at June 30, 2016	\$ 197	\$ 177,995	\$ 36,845	\$(8,811)	\$ 481	\$ 206,707

See accompanying notes to the consolidated financial statements.

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

	Six Months Ended June 30,	
	2016	2015
Cash flows from operating activities		
Net income	\$2,735	\$4,210
Adjustments to reconcile to net income to net cash from operating activities		
Provision for (recovery of) loan losses	825	(1,212)
ESOP shares earned	583	571
Stock-based compensation expense	768	52
Depreciation and amortization	1,872	1,835
Amortization of premiums and discounts on securities and loans	(77)	(151)
Amortization of core deposit intangible	265	278
Amortization and impairment of servicing assets	68	57
Net change in net deferred loan origination costs	(37)	(322)
Net gain on sale of other real estate owned	—	(80)
Net gain on sale of loans	(21)	(55)
Net gain on sale of securities	(46)	—
Net loss on disposition of premises and equipment	—	1
Loans originated for sale	(503)	(2,324)
Proceeds from sale of loans	524	2,379
Other real estate owned valuation adjustments	129	236
Net change in:		
Accrued interest receivable	226	41
Earnings on bank owned life insurance	(97)	(94)
Other assets	1,955	3,999
Accrued interest payable and other liabilities	(682)	(270)
Net cash from operating activities	8,487	9,151
Cash flows from investing activities		
Securities		
Proceeds from maturities	38,523	40,011
Proceeds from principal repayments	2,263	4,491
Proceeds from sales of securities	46	—
Purchases of securities	(31,857)	(22,702)
Loans receivable		
Loan participations sold	—	3,350
Principal payments on loans receivable	249,183	230,146
Proceeds of loan sale	14,746	—
Originated for investment	(240,574)	(218,045)
Proceeds from sale of other real estate owned	1,630	1,830
Purchase of premises and equipment, net	(317)	(282)
Net cash from investing activities	33,643	38,799

Continued

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

	Six Months Ended	
	June 30,	
	2016	2015
Cash flows from financing activities		
Net change in deposits	\$55,683	\$(11,487)
Net change in borrowings	(62,849)	(9,882)
Net change in advance payments by borrowers for taxes and insurance	893	340
Repurchase and retirement of common stock	(7,673)	(7,388)
Cash dividends paid on common stock	(2,004)	(1,688)
Net cash used in financing activities	(15,950)	(30,105)
Net change in cash and cash equivalents	26,180	17,845
Beginning cash and cash equivalents	59,377	59,581
Ending cash and cash equivalents	\$85,557	\$77,426
Supplemental disclosures of cash flow information:		
Interest paid	\$1,710	\$1,413
Income taxes paid	175	26
Loans transferred to other real estate owned	121	1,167

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”). The interim unaudited consolidated financial statements include the accounts of and transactions of BankFinancial Corporation, the Bank, and the Bank’s wholly-owned subsidiaries, Financial Assurance Services, Inc. and BF Asset Recovery Corporation (collectively, “the Company”), and reflect all normal and recurring adjustments that are, in the opinion of management, considered necessary for a fair presentation of the financial condition and results of operations for the periods presented. All significant intercompany accounts and transactions have been eliminated. The results of operations for the three- and six-month periods ended June 30, 2016 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2016.

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, 2015, as filed with the Securities and Exchange Commission.

Recent Accounting Pronouncements

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 originally were to become effective for annual periods and interim periods within those annual periods beginning after December 15, 2016. During 2015, the FASB delayed the effectiveness by one year to annual periods and interim periods beginning after December 15, 2017. We are currently evaluating the impact of adopting the new guidance on the consolidated financial statements.

On January 5, 2016, the FASB issued an update (ASU No. 2016-01, Financial Instruments - Recognition and Measurement of Financial Assets and Liabilities). The new guidance is intended to improve the recognition and measurement of financial instruments by requiring: equity investments (other than equity method or consolidation) to be measured at fair value with changes in fair value recognized in net income; public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; separate presentation of financial assets and financial liabilities by measurement category and form of financial assets (i.e. securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; eliminating the requirement to disclose the fair value of financial instruments measured at amortized cost for organizations that are not public business entities; eliminating the requirement for non-public business entities to disclose the method(s) and

significant assumptions used to estimate the fair value that is to be required to be disclosed for financial instruments measured at amortized cost on the balance sheet; and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in fair value of a liability resulting from the change in the instrument-specific credit risk (also referred to as “own credit”) when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The new guidance is effective for public business entities for fiscal years beginning after December 15, 2017. We are currently evaluating the impact of adopting the new guidance on the consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”). The standard requires a lessee to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 months. ASU 2016-02 is effective

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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

for fiscal years, and interim periods within those years, beginning after December 15, 2018, and early adoption is permitted. We are currently evaluating the impact that the standard will have on our consolidated financial statements. In March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). The standard is intended to simplify several areas of accounting for share-based compensation arrangements, including the income tax impact, classification on the statement of cash flows and forfeitures. ASU 2016-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is permitted. We are currently evaluating the impact that the standard will have on our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"). These amendments require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019 (i.e., January 1, 2020, for calendar year entities). Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. We are currently evaluating the impact that the standard will have on our consolidated 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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income available to common stockholders	\$831	\$ 2,224	\$2,735	\$ 4,210
Average common shares outstanding	19,827,582	20,811,856	19,991,562	20,956,110
Less:				
Unearned ESOP shares	(694,773)	(792,816)	(706,941)	(804,864)
Unvested restricted stock shares	(2,690)	(9,682)	(5,290)	(13,201)
Weighted average common shares outstanding	19,130,119	19,009,358	19,279,331	19,138,045
Add - Net effect of dilutive unvested restricted stock	317	4,215	312	4,160
Diluted weighted average common shares outstanding	19,130,436	19,013,573	19,279,643	19,142,205
Basic earnings per common share	\$0.04	\$ 0.11	\$0.14	\$ 0.21
Diluted earnings per common share	\$0.04	\$ 0.11	\$0.14	\$ 0.21
Number of antidilutive stock options excluded from the diluted earnings per share calculation	536,459	—	536,459	—
Weighted average exercise price of anti-dilutive option shares	\$12.99	\$ —	\$12.99	\$ —

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 3 - SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2016				
Certificates of deposit	\$ 81,376	\$ —	\$ —	\$ 81,376
Equity mutual fund	500	17	—	517
Mortgage-backed securities - residential	16,677	762	—	17,439
Collateralized mortgage obligations - residential	6,345	22	(21)	6,346
SBA-guaranteed loan participation certificates	20	—	—	20
	\$ 104,918	\$ 801	\$ (21)	\$ 105,698
December 31, 2015				
Certificates of deposit	\$ 87,901	\$ —	\$ —	\$ 87,901
Equity mutual fund	500	7	—	507
Mortgage-backed securities - residential	18,330	880	(30)	19,180
Collateralized mortgage obligations - residential	7,111	41	(10)	7,142
SBA-guaranteed loan participation certificates	23	—	—	23
	\$ 113,865	\$ 928	\$ (40)	\$ 114,753

The mortgage-backed securities and collateralized mortgage obligations reflected in the preceding table were issued by U.S. government-sponsored entities or agencies, Freddie Mac, Fannie Mae and Ginnie Mae, and are obligations which the government has affirmed its commitment to support. All securities reflected in the preceding table were classified as available-for-sale at June 30, 2016 and December 31, 2015.

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

	June 30, 2016	
	Amortized Cost	Fair Value
Due in one year or less	\$ 81,376	\$ 81,376
Equity mutual fund	500	517
Mortgage-backed securities - residential	16,677	17,439
Collateralized mortgage obligations - residential	6,345	6,346
SBA-guaranteed loan participation certificates	20	20
	\$ 104,918	\$ 105,698

Sales of securities were as follows:

	Three Months Ended June 30, 2016	Six Months Ended June 30, 2015		
Proceeds	\$ —	\$ —	\$ 46	\$ —
Gross gains	—	—	46	—
Gross losses	—	—	—	—

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 3 - SECURITIES (continued)

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

	Less than 12		12 Months or		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
June 30, 2016						
Collateralized mortgage obligations - residential	\$3,216	\$ (13)	\$1,171	\$ (8)	\$4,387	\$ (21)
December 31, 2015						
Mortgage-backed securities - residential	\$—	\$ —	\$1,724	\$ (30)	\$1,724	\$ (30)
Collateralized mortgage obligations - residential	—	—	1,299	(10)	1,299	(10)
	\$—	\$ —	\$3,023	\$ (40)	\$3,023	\$ (40)

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 collateralized mortgage obligations that the Company holds in its investment portfolio were in an unrealized loss position at June 30, 2016, 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.

NOTE 4 - LOANS RECEIVABLE

Loans receivable are as follows:

	June 30, 2016	December 31, 2015
One-to-four family residential real estate	\$147,876	\$159,501
Multi-family mortgage	504,158	506,026
Nonresidential real estate	191,685	226,735
Construction and land	1,767	1,313
Commercial loans	84,951	79,516
Commercial leases	282,629	265,405
Consumer	1,744	1,831
	1,214,810	1,240,327
Net deferred loan origination costs	1,658	1,621
Allowance for loan losses	(8,915)	(9,691)
Loans, net	\$1,207,553	\$1,232,257

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

	Allowance for loan losses			Loan Balances		
	Individually evaluated for impairment	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Collectively evaluated for impairment	Total
June 30, 2016						
One-to-four family residential real estate	\$—	\$ 1,321	\$ 1,321	\$ 3,210	\$ 144,666	\$ 147,876
Multi-family mortgage	54	3,430	3,484	1,633	502,525	504,158
Nonresidential real estate	27	2,344	2,371	751	190,934	191,685
Construction and land	—	53	53	—	1,767	1,767
Commercial loans	—	645	645	—	84,951	84,951
Commercial leases	—	1,010	1,010	—	282,629	282,629
Consumer	—	31	31	—	1,744	1,744
	\$ 81	\$ 8,834	\$ 8,915	\$ 5,594	\$ 1,209,216	1,214,810
Net deferred loan origination costs						1,658
Allowance for loan losses						(8,915)
Loans, net						\$ 1,207,553
December 31, 2015						
One-to-four family residential real estate	\$—	\$ 1,704	\$ 1,704	\$ 2,672	\$ 156,829	\$ 159,501
Multi-family mortgage	41	3,569	3,610	2,879	503,147	506,026
Nonresidential real estate	3	2,579	2,582	2,099	224,636	226,735
Construction and land	—	43	43	—	1,313	1,313
Commercial loans	—	654	654	—	79,516	79,516
Commercial leases	—	1,073	1,073	—	265,405	265,405
Consumer	—	25	25	—	1,831	1,831
	\$ 44	\$ 9,647	\$ 9,691	\$ 7,650	\$ 1,232,677	1,240,327
Net deferred loan origination costs						1,621
Allowance for loan losses						(9,691)
Loans, net						\$ 1,232,257

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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		Six Months Ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Beginning balance	\$9,416	\$11,576	\$9,691	\$11,990
Loans charged off:				
One-to-four family residential real estate	(355)	(99)	(407)	(202)
Multi-family mortgage	(6)	(161)	(51)	(180)
Nonresidential real estate	(1,657)	(252)	(1,660)	(263)
Commercial loans	—	—	—	(98)
Consumer	(2)	(4)	(18)	(8)
	(2,020)	(516)	(2,136)	(751)
Recoveries:				
One-to-four family residential real estate	6	219	87	279
Multi-family mortgage	9	4	146	8
Nonresidential real estate	161	9	161	25
Construction and land	—	—	35	6
Commercial loans	28	6	105	463
Commercial leases	—	—	—	1
Consumer	—	—	1	1
	204	238	535	783
Net recoveries (charge-offs)	(1,816)	(278)	(1,601)	32
Provision for (recovery of) loan losses	1,315	(488)	825	(1,212)
Ending balance	\$8,915	\$10,810	\$8,915	\$10,810

Impaired loans

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

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

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

					Three months ended June 30, 2016	Six months ended June 30, 2016		
	Loan Balance	Recorded Investment	Partial Charge-off	Allowance for Loan Losses Allocated	Average Investment in Impaired Loans	Interest Income Recognized	Average Investment in Impaired Loans	Interest Income Recognized
June 30, 2016								
With no related allowance recorded:								
One-to-four family residential real estate	\$ 2,930	\$ 2,996	\$ 695	\$ —	\$ 2,921	\$ 8	\$ 2,713	\$ 15
One-to-four family residential real estate - non-owner occupied	90	192	2	—	192	—	119	—
Multi-family mortgage - Illinois	991	990	—	—	936	10	1,197	21
Nonresidential real estate	461	456	—	—	1,481	—	1,626	4
	4,472	4,634	697	—	5,530	18	5,655	40
With an allowance recorded:								
Multi-family mortgage - Illinois	640	643	51	54	646	—	591	—
Nonresidential real estate	276	297	48	27	103	—	75	—
	916	940	99	81	749	—	666	—
	\$ 5,388	\$ 5,574	\$ 796	\$ 81	\$ 6,279	\$ 18	\$ 6,321	\$ 40
Year ended December 31, 2015								
	Loan Balance	Recorded Investment	Partial Charge-off	Allowance for Loan Losses Allocated	Average Investment in Impaired Loans	Interest Income Recognized		
December 31, 2015								
With no related allowance recorded:								
One-to-four family residential real estate	\$ 3,203	\$ 2,637	\$ 637	\$ —	\$ 2,708	\$ 24		
One-to-four family residential real estate - non-owner occupied	23	21	2	—	859	—		
Multi-family mortgage - Illinois	1,863	1,837	—	—	1,962	78		
Multi-family mortgage - Other	511	507	—	—	514	34		
Nonresidential real estate	2,066	2,049	—	—	1,877	102		
	7,666	7,051	639	—	7,920	238		
With an allowance recorded:								
Multi-family mortgage - Illinois	518	518	—	41	1,181	—		
Nonresidential real estate	62	39	27	3	1,439	—		
	580	557	27	44	2,620	—		
	\$ 8,246	\$ 7,608	\$ 666	\$ 44	\$ 10,540	\$ 238		

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

Nonaccrual Loans

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

	Loan Balance	Recorded Investment	Loans Past Due Over 90 Days, Still Accruing
June 30, 2016			
One-to-four family residential real estate	\$ 2,881	\$ 2,433	\$ —
One-to-four family residential real estate – non owner occupied	92	192	—
Multi-family mortgage - Illinois	1,074	1,021	—
Nonresidential real estate	785	754	—
Land	828	—	828
	\$ 5,660	\$ 4,400	\$ 828
December 31, 2015			
One-to-four family residential real estate	\$ 2,704	\$ 2,263	\$ —
One-to-four family residential real estate – non owner occupied	92	192	—
Multi-family mortgage - Illinois	829	821	—
Nonresidential real estate	324	296	—
	\$ 3,949	\$ 3,572	\$ —

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 \$238,000 and \$181,000 at June 30, 2016 and December 31, 2015, respectively. When a loan is on nonaccrual status and the ultimate collectability of the total principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. Alternatively, when a loan is on non-accrual status but there is doubt concerning only the ultimate collectability of interest, contractual interest is credited to interest income only when received, under the cash basis method pursuant to the provisions of FASB ASC 310-10, as applicable. In all cases, the average balances are calculated based on the month-end balances of the financing receivables within the period reported pursuant to the provisions of FASB ASC 310-10, as applicable.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

Past Due Loans

The following tables present the aging of the recorded investment of loans at June 30, 2016 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
One-to-four family residential real estate loans	\$ 94	\$ 299	\$ 2,022	\$ 2,415	\$ 103,167	\$ 105,582
One-to-four family residential real estate loans – non-owner occupied	2	4	192	198	41,304	41,502
Multi-family mortgage - Illinois	—	—	1,020	1,020	298,492	299,512
Multi-family mortgage - Other	—	—	—	—	199,773	199,773
Nonresidential real estate	—	—	754	754	187,802	188,556
Construction	—	—	—	—	537	537
Land	—	—	842	842	398	1,240
Commercial loans:						
Regional commercial banking	—	—	—	—	35,121	35,121
Health care	—	—	—	—	27,726	27,726
Direct commercial lessor	—	—	—	—	22,381	22,381
Commercial leases:						
Investment rated commercial leases	121	—	—	121	200,115	200,236
Other commercial leases	—	—	—	—	83,999	83,999
Consumer	—	—	—	—	1,751	1,751
	\$ 217	\$ 303	\$ 4,830	\$ 5,350	\$ 1,202,566	\$ 1,207,916

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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, 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 loans	\$ 2,000	\$ 572	\$ 1,997	\$ 4,569	\$ 109,893	\$ 114,462
One-to-four family residential real estate loans – non-owner occupied	299	164	192	655	43,557	44,212
Multi-family mortgage - Illinois	651	283	821	1,755	312,620	314,375
Multi-family mortgage - Other	—	—	—	—	188,178	188,178
Nonresidential real estate	—	—	296	296	223,018	223,314
Construction	—	—	—	—	21	21
Land	—	—	—	—	1,279	1,279
Commercial loans:						
Regional commercial banking	4	150	—	154	29,890	30,044
Health care	—	—	—	—	31,862	31,862
Direct commercial lessor	—	—	—	—	17,873	17,873
Commercial leases:						
Investment rated commercial leases	50	363	—	413	170,859	171,272
Other commercial leases	—	—	—	—	95,800	95,800
Consumer	21	—	—	21	1,819	1,840
	\$ 3,025	\$ 1,532	\$ 3,306	\$ 7,863	\$ 1,226,669	\$ 1,234,532

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 Troubled Debt Restructuring ("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 \$419,000 of TDRs at June 30, 2016, compared to \$2.7 million at December 31, 2015. No specific valuation reserves were allocated to those loans at June 30, 2016 and December 31, 2015. The Company had no outstanding commitments to borrowers whose loans were classified as TDRs at either date. During the first quarter of 2016, six loans totaling \$1.5 million were declassified as TDRs as they successfully met the regulatory criteria to be removed from TDR status.

The following table presents loans classified as TDRs:

	June 30, 2016	December 31, 2015
One-to-four family residential real estate	\$ 187	\$ 1,385
Multi-family mortgage	—	1,119
Troubled debt restructured loans – accrual loans	187	2,504
One-to-four family residential real estate	232	174

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Troubled debt restructured loans – nonaccrual loans	232	174
Total troubled debt restructured loans	\$ 419	\$ 2,678

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

NOTE 4 - LOANS RECEIVABLE (continued)

During the six months ending June 30, 2016 and 2015, 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. There was no new TDR activity for the three months ending June 30, 2016 and 2015.

The following tables present TDR activity:

	Six Months Ended June 30, 2016		2015	
	Pre-Modification Number of outstanding loans recorded investment	Post-Modification outstanding recorded investment	Pre-Modification Number of outstanding loans recorded investment	Post-Modification outstanding recorded investment
One-to-four family residential real estate	1 \$ 63	\$ 63	1 \$ 63	\$ 63
			Due to permanent reduction in recorded investment	Total
	Due to reduction in interest rate	Due to extension of maturity date		

For the Six Months Ended June 30, 2016

One-to-four family residential real estate	\$	—	\$ 63	\$	—	\$ 63
--	----	---	-------	----	---	-------

For the Six Months Ended June 30, 2015

One-to-four family residential real estate	\$	—	\$ 63	\$	—	\$ 63
--	----	---	-------	----	---	-------

The TDRs described above had no impact on interest income, resulted in no change to the allowance for loan losses allocated and resulted in no charge-offs for the six months ended June 30, 2016. The TDRs had no material impact on interest income, resulted in no change to the allowance for loan losses allocated and resulted in no charge-offs for the six months ended June 30, 2015.

The following table presents TDRs for which there was a payment default during the six months ended June 30, 2016 and 2015 within twelve months following the modification.

	2016	2015
	Number Recorded of investment loans	Number Recorded of investment loans
One-to-four family residential real estate	3 \$ 104	2 \$ 77

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

The TDRs for which there was a payment default resulted in no change to the allowance for loan losses allocated and resulted in no charge-offs during the six months ended June 30, 2016 and 2015.

There were certain other loan modifications during the three and six months ended June 30, 2016 and 2015 that did not meet the definition of a TDR. These loans had a total recorded investment of \$255,000 and \$2.3 million at June 30, 2016 and 2015, 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

Credit Quality Indicators

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

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

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

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

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

As of June 30, 2016, 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 loans	\$ 103,885	\$ —	\$ 335	\$ 1,854	\$ 106,074
One-to-four family residential real estate loans – non-owner occupied	41,397	213	—	192	41,802
Multi-family mortgage loans - Illinois	299,839	334	2,025	1,024	303,222
Multi-family mortgage loans - Other	200,936	—	—	—	200,936
Nonresidential real estate loans	187,740	—	3,194	751	191,685
Construction loans	534	—	—	—	534
Land loans	403	—	830	—	1,233
Commercial loans:					
Regional commercial banking	34,816	—	225	—	35,041
Health care	27,695	—	—	—	27,695
Direct commercial lessor	21,565	650	—	—	22,215
Commercial leases:					
Investment rated commercial leases	199,020	—	—	—	199,020
Other commercial leases	83,393	216	—	—	83,609
Consumer	1,742	—	2	—	1,744
	\$ 1,202,965	\$ 1,413	\$ 6,611	\$ 3,821	\$ 1,214,810

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

As of December 31, 2015, 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 loans	\$112,449	\$—	\$ 576	\$ 1,936	\$114,961
One-to-four family residential real estate loans – non-owner occupied	43,858	219	271	192	44,540
Multi-family mortgage loans - Illinois	312,329	344	4,656	828	318,157
Multi-family mortgage loans - Other	187,358	—	511	—	187,869
Nonresidential real estate loans	219,859	1,600	4,981	295	226,735
Construction loans	21	—	—	—	21
Land loans	450	—	842	—	1,292
Commercial loans:					
Regional commercial banking	29,377	—	614	—	29,991
Health care	31,809	—	—	—	31,809
Direct commercial lessor	17,716	—	—	—	17,716
Commercial leases:					
Investment rated commercial leases	170,100	—	—	—	170,100
Other commercial leases	95,305	—	—	—	95,305
Consumer	1,831	—	—	—	1,831
	\$1,222,462	\$2,163	\$ 12,451	\$ 3,251	\$1,240,327

NOTE 5 - OTHER REAL ESTATE OWNED

Real estate that is acquired through foreclosure or a deed in lieu of foreclosure is classified as other real estate owned ("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.

	June 30, 2016			December 31, 2015		
	Balance	Valuation Allowance	Net OREO Balance	Balance	Valuation Allowance	Net OREO Balance
One-to-four family residential	\$2,506	\$ (73)	\$ 2,433	\$2,684	\$ (63)	\$ 2,621
Multi-family mortgage	774	(37)	737	1,025	(74)	951
Nonresidential real estate	1,307	(242)	1,065	1,986	(239)	1,747
Land	1,450	(312)	1,138	2,358	(666)	1,692
	\$6,037	\$ (664)	\$ 5,373	\$8,053	\$ (1,042)	\$ 7,011

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5 - OTHER REAL ESTATE OWNED (continued)

The following represents the roll forward of OREO and the composition of OREO properties:

	For the Three Months Ended June 30, 2016		For the Six Months Ended June 30, 2015	
	Beginning balance	\$5,629	\$6,316	\$7,011
New foreclosed properties	56	578	121	1,167
Valuation adjustments	(10)	(23)	(129)	(236)
Sales	(302)	(1,332)	(1,630)	(1,750)
Ending balance	\$5,373	\$5,539	\$5,373	\$5,539

Activity in the valuation allowance is as follows:

	For the Three Months Ended June 30, 2016		For the Six Months Ended June 30, 2015	
	Beginning balance	\$654	\$1,109	\$1,042
Additions charged to expense	10	22	129	235
Reductions from sales of other real estate owned	—	(29)	(507)	(29)
Ending balance	\$664	\$1,102	\$664	\$1,102

NOTE 6 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase, included with borrowings on the consolidated balance sheet, are shown below.

	June 30, 2016			
	Overnight and Continu days	30 - to 30 90 days	Greater Than 90 days	Total
Repurchase agreements and repurchase-to-maturity transactions	\$1,469	\$ —	\$ —	—\$1,469
Gross amount of recognized liabilities for repurchase agreements	in Statement of Condition December 31, 2015			\$1,469

	December 31, 2015			
	Overnight and Continu days	30 - to 30 90 days	Greater Than 90 days	Total
Repurchase agreements and repurchase-to-maturity transactions	\$2,318	\$ —	\$ —	—\$2,318
Gross amount of recognized liabilities for repurchase agreements	in Statement of Condition December 31, 2015			\$2,318

Securities sold under agreements to repurchase were secured by mortgage-backed securities with a carrying amount of \$5.5 million and \$6.0 million at June 30, 2016 and December 31, 2015, respectively. Also included in total borrowings were advances from the FHLBC of \$62.0 million at December 31, 2015 and none at June 30, 2016.

Because 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 to the counterparty if the market value of the securities falls below the repurchase price, per the agreement.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7 - 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).

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

Impaired Loans: 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).

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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7 - FAIR VALUE (continued)

NOTE 7 - FAIR VALUE (continued)

	Fair Value Measurements Using			
	Quoted			
	Prices			
	in	Significant	Significant	Fair
	Active	Observable	Unobservable	Value
	Markets for	Inputs	Inputs	
	Identical	(Level 2)	(Level 3)	
	Assets			
	(Level			
	1)			
June 30, 2016				
Securities:				
Certificates of deposit	\$—	\$ 81,376	\$	—\$81,376
Equity mutual fund	517	—	—	517
Mortgage-backed securities – residential	—	17,439	—	17,439
Collateralized mortgage obligations – residential	—	6,346	—	6,346
SBA-guaranteed loan participation certificates	—	20	—	20
	\$517	\$ 105,181	\$	—\$105,698
December 31, 2015				
Securities:				
Certificates of deposit	\$—	\$ 87,901	\$	—\$87,901
Equity mutual fund	507	—	—	507
Mortgage-backed securities - residential	—	19,180	—	19,180
Collateralized mortgage obligations – residential	—	7,142	—	7,142
SBA-guaranteed loan participation certificates	—	23	—	23
	\$507	\$ 114,246	\$	—\$114,753

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7 - FAIR VALUE (continued)

NOTE 7 - 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		
	Quoted		
	Prices in		
	Active	Significant	Significant
	Markets	Observable	Unobservable
	for	Inputs	Inputs
	Identical	(Level 2)	(Level 3)
	Assets		
	(Level		Fair
	1)		Value
June 30, 2016			
Impaired loans:			
Multi-family mortgage	\$—	\$ 589	\$589
Nonresidential real estate	—	270	270
	\$—	\$ 859	\$859
Other real estate owned:			
One-to-four family residential real estate	\$—	\$ 33	\$33
Nonresidential real estate	—	674	674
	\$—	\$ 707	\$707
Mortgage servicing rights	\$— 253	\$ —	\$253
December 31, 2015			
Impaired loans:			
Multi-family mortgage	\$—	\$ 477	\$477
Nonresidential real estate	—	36	36
	\$—	\$ 513	\$513
Other real estate owned:			
One-to-four family residential real estate	\$—	\$ 42	\$42
Multi-family mortgage	—	354	354
Nonresidential real estate	—	474	474
Land	—	794	794
	\$—	\$ 1,664	\$1,664
Mortgage servicing rights	\$— 281	\$ —	\$281

Impaired loans that are measured for impairment using the fair value of the collateral for collateral-dependent loans and which have specific valuation allowances had a carrying amount of \$940,000, with a valuation allowance of \$81,000 at June 30, 2016, compared to a carrying amount of \$557,000 and a valuation allowance of \$44,000 at December 31, 2015. The increase in the valuation allowance resulted in an increase in the provision for loan losses of

\$37,000 for the six months ended June 30, 2016. There was a decrease in the provision for loan losses of \$405,000 for the six months ended June 30, 2015.

Other real estate owned ("OREO"), which is carried at the lower of cost or fair value less costs to sell, had a carrying value of \$1.0 million less a valuation allowance of \$299,000, or \$707,000 at June 30, 2016, compared to a carrying value of \$2.5 million less a valuation allowance of \$881,000, or \$1.7 million at December 31, 2015. There were \$129,000 of valuation adjustments of OREO recorded for the six months ended June 30, 2016. There were \$236,000 of valuation adjustments of OREO recorded for the six months ended June 30, 2015.

Mortgage servicing rights, which are carried at lower of cost or fair value, had a carrying amount of \$253,000 at June 30, 2016, and a carrying amount of \$281,000 at December 31, 2015. There was no pre-tax provision for our mortgage servicing rights

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7 - FAIR VALUE (continued)

NOTE 7 - FAIR VALUE (continued)

portfolio included in noninterest income for the six months ended June 30, 2016, compared to a pre-tax recovery of \$13,000 for the same period in 2015.

The following table presents quantitative information, based on certain empirical data with respect to Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at June 30, 2016:

	Fair Value	Valuation Technique(s)	Significant Unobservable Input(s)	Range (Weighted Average)
Impaired loans:				
Multi-family mortgage loans	\$ 589	Sales comparison	Comparison between sales and income approaches	35.6% to 89.3% (43%)
		Income approach	Cap Rate	10.0%
Nonresidential real estate loans	270	Sales comparison	Comparison between sales and income approaches	-10.2% to 1.2% (-9%)
		Income approach	Cap Rate	8.5%
Impaired loans	\$ 859			
Other real estate owned:				
One-to-four family residential real estate	\$ 33	Sales comparison	Discount applied to valuation	8.6%
Nonresidential real estate loans	674	Sales comparison	Comparison between sales and income approaches	-3.2% to 54.9% (11%)
Other real estate owned	\$ 707			

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7 - FAIR VALUE (continued)

NOTE 7 - 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, 2015:

	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans				
Multi-family mortgage	\$ 477	Sales comparison	Comparison between sales and income approaches	39.3%
		Income approach	Cap Rate	8.75%
Nonresidential real estate	36	Sales comparison	Comparison between sales and income approaches	1.2%
	\$ 513			
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	354	Sales comparison	Comparison between sales and income approaches	-67.74% to 10.37% (-13%)
Nonresidential real estate	474	Sales comparison	Comparison between sales and income approaches	-15.6% to 1.46% (-5%)
Land	794	Sales comparison	Discount applied to valuation	-7.7% to 17.24% (6%)
	\$ 1,664			

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7 - FAIR VALUE (continued)

NOTE 7 - FAIR VALUE (continued)

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

	Carrying Amount	Fair Value Measurements at June 30, 2016 Using:			Total
		Level 1	Level 2	Level 3	
Financial assets					
Cash and cash equivalents	\$85,557	\$11,509	\$74,048	\$	-\$85,557
Securities	105,698	517	105,181	—	105,698
Loans receivable, net of allowance for loan losses	1,207,553	—	1,230,988	859	1,231,847
FHLBC stock	6,257	—	—	—	N/A
Accrued interest receivable	4,000	—	4,000	—	4,000
Financial liabilities					
Noninterest-bearing demand deposits	\$231,928	\$—	\$231,928	\$	-\$231,928
Savings deposits	158,669	—	158,669	—	158,669
NOW and money market accounts	573,698	—	573,698	—	573,698
Certificates of deposit	304,307	—	304,840	—	304,840
Borrowings	1,469	—	1,469	—	1,469
Accrued interest payable	66	—	66	—	66
	Carrying Amount	Fair Value Measurements at December 31, 2015 Using:			Total
		Level 1	Level 2	Level 3	
Financial assets					
Cash and cash equivalents	\$59,377	\$13,192	\$46,185	\$	-\$59,377
Securities	114,753	507	114,246	—	114,753
Loans receivable, net of allowance for loan losses	1,232,257	—	1,240,791	513	1,241,304
FHLBC stock	6,257	—	—	—	N/A
Accrued interest receivable	4,226	—	4,226	—	4,226
Financial liabilities					
Noninterest-bearing demand deposits	\$254,830	\$—	\$254,830	\$	-\$254,830
Savings deposits	156,752	—	156,752	—	156,752
NOW and money market accounts	578,636	—	578,636	—	578,636
Certificates of deposit	222,701	—	222,026	—	222,026
Borrowings	64,318	—	64,318	—	64,318
Accrued interest payable	39	—	39	—	39

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

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

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

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

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7 - FAIR VALUE (continued)

NOTE 7 - FAIR VALUE (continued)

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

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

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

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

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

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

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

Cautionary Statement Regarding Forward-Looking Information

Forward Looking Statements

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

Factors that could cause actual results to differ materially from the results anticipated or projected and which could materially and adversely affect our operating results, financial condition or future prospects include, but are not limited to: (i) less than anticipated loan growth due to intense competition for high quality loans and leases, particularly in terms of pricing and credit underwriting, or a dearth of borrowers who meet our underwriting

standards; (ii) the impact of re-pricing and competitors' pricing initiatives on loan and deposit products; (iii) interest rate movements and their impact on the economy, customer behavior and our net interest margin; (iv) adverse economic conditions in general and in the Chicago metropolitan area in particular that could result in increased delinquencies in our loan portfolio or a decline in the value of our investment securities and the collateral for our loans; (v) declines in real estate values that adversely impact the value of our loan collateral, Other Real Estate Owned ("OREO"), asset dispositions and the level of borrower equity in their investments; (vi) borrowers that experience legal or financial difficulties that we do not currently foresee; (vii) results of supervisory monitoring or examinations by regulatory authorities, including the possibility that a regulatory authority could, among other things, require us to increase our allowance for loan losses or adversely change our loan classifications, write-down assets, reduce credit concentrations or maintain specific capital levels; (viii) changes, disruptions or illiquidity in national or global financial markets; (ix) the credit risks of lending activities, including risks that could cause changes in the level and direction of loan delinquencies and charge-offs or changes in estimates relating to the computation of our allowance

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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, including the risks of business interruption and the compromise of confidential customer information resulting from intrusions.

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, 2015 and this Quarterly Report on Form 10-Q, 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, 2015, and all amendments thereto, as filed with the Securities and Exchange Commission.

Overview

Loan originations for the second quarter of 2016 reflected continued growth in commercial and industrial loan categories, including exceptionally strong growth in investment-grade commercial equipment leases. The strong loan originations growth was partially offset by higher payoffs of commercial leases, as lessors continue to actively manage their portfolios and maximize residual realization, and due to our syndication of certain exposures to manage concentration of credit risk.

Multi-family loan originations were lower than the historical seasonal average, due in part to reduced marketing activity early in the quarter in response to changes in market conditions. Multi-family loan payoffs continued to be elevated as investors elected to sell rather than retain their apartment buildings given the highly favorable real estate market conditions in many geographic markets.

We expect to continue to increase loan portfolio balances for commercial loans and commercial leases, and resume growth for multi-family loans during the remainder of 2016; however, the precise timing of loan origination and loan payoff activity continues to be difficult to predict. Market volatility related to global events continued in the second quarter of 2016 in terms of both index values and credit spreads. In response to the changes in market conditions, we updated our credit parameters and pricing to maximize our commercial loan and lease origination opportunities with yields consistent with our established risk allocations and ever-increasing competitive forces. As a result of these actions, we experienced higher commercial lease, commercial loan and multi-family loan originations late in the second quarter with accelerated activity continuing into the third quarter of 2016.

Deposit balances increased due to our focus on increasing medium-duration certificates of deposit for asset-liability management purposes. Other deposit categories were essentially constant with typical seasonal fluctuations.

Net interest income declined modestly during the second quarter of 2016 due to lower average loan balances and lower yields. We expect that net interest income can resume its long-term growth trend, but the timing and extent of net interest income growth is to a greater extent dependent on the volume and relative mix of future loan originations, and to a lesser extent on loan payoffs and loan repricing.

Noninterest income declined due to lower check deposit and presentment volumes, partially offset by improved deposit account management, insurance, wealth management and trust income. Noninterest expense declined despite higher expenses for equity-based compensation, information technology, and seasonal employee benefits costs. We

expect further improvement to noninterest expense during the remainder of 2016 as we assess business unit and departmental productivity in light of current market conditions and expenses for equity-based compensation decline. Our ratio of classified assets to total capital declined in the second quarter of 2016. Past due loans, non-performing loans and non-performing assets all declined during the quarter due to additional credit resolutions. Based on current conditions and various actions we have taken to mitigate risk in our loan portfolio, we expect asset quality to remain strong.

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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.

	June 30, 2016	December 31, 2015	Change			
(Dollars in thousands)						
Selected Financial Condition Data:						
Total assets	\$1,499,831	\$1,512,443	\$(12,612)			
Loans, net	1,207,553	1,232,257	(24,704)			
Securities, at fair value	105,698	114,753	(9,055)			
Other real estate owned, net	5,373	7,011	(1,638)			
Deposits	1,268,602	1,212,919	55,683			
Borrowings	1,469	64,318	(62,849)			
Equity	206,707	212,364	(5,657)			
	Three Months Ended June 30,			Six Months Ended June 30,		
	2016	2015	Change	2016	2015	Change
(Dollars in thousands)						
Selected Operating Data:						
Interest and dividend income	\$12,581	\$12,193	\$388	\$25,340	\$24,404	\$936
Interest expense	952	691	261	1,808	1,377	431
Net interest income	11,629	11,502	127	23,532	23,027	505
Provision for (recovery of) loan losses	1,315	(488)	1,803	825	(1,212)	2,037
Net interest income after provision for (recovery of) loan losses	10,314	11,990	(1,676)	22,707	24,239	(1,532)
Noninterest income	1,537	1,689	(152)	3,131	3,225	(94)
Noninterest expense	10,506	10,031	475	21,436	20,544	892
Income before income tax expense	1,345	3,648	(2,303)	4,402	6,920	(2,518)
Income tax expense	514	1,424	(910)	1,667	2,710	(1,043)
Net income	\$831	\$2,224	\$(1,393)	\$2,735	\$4,210	\$(1,475)

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	Three Months		Six Months	
	Ended		Ended	
	June 30,	June 30,	June 30,	June 30,
	2016	2015	2016	2015
Selected Financial Ratios and Other Data:				
Performance Ratios:				
Return on assets (ratio of net income to average total assets) ⁽¹⁾	0.22 %	0.61 %	0.36 %	0.58 %
Return on equity (ratio of net income to average equity) ⁽¹⁾	1.59	4.14	2.60	3.88
Average equity to average assets	13.86	14.84	13.94	14.96
Net interest rate spread ⁽¹⁾⁽²⁾	3.21	3.36	3.25	3.40
Net interest margin ⁽¹⁾⁽³⁾	3.31	3.42	3.35	3.45
Efficiency ratio ⁽⁴⁾	79.80	76.04	80.40	78.26
Noninterest expense to average total assets ⁽¹⁾	2.78	2.77	2.84	2.84
Average interest-earning assets to average interest-bearing liabilities	136.17	131.42	136.21	128.03
Dividends declared per share	\$0.05	\$0.04	\$0.10	\$0.08
Dividend payout ratio	119.60%	37.95 %	73.27 %	40.10 %
	At June	At		
	30, 2016	December		
		31, 2015		
Asset Quality Ratios:				
Nonperforming assets to total assets ⁽⁵⁾	0.71 %	0.70 %		
Nonperforming loans to total loans	0.43	0.29		
Allowance for loan losses to nonperforming loans	170.52	271.30		
Allowance for loan losses to total loans	0.73	0.78		
Capital Ratios:				
Equity to total assets at end of period	13.78 %	14.04 %		
Tier 1 leverage ratio (Bank only)	10.25 %	11.33 %		
Other Data:				
Number of full-service offices	19	19		
Employees (full-time equivalents)	253	251		

(1) Ratios annualized.

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

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

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

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

Comparison of Financial Condition at June 30, 2016 and December 31, 2015

Total assets decreased \$12.6 million, or 0.8%, to \$1.500 billion at June 30, 2016 from \$1.512 billion at December 31, 2015. The decrease in total assets was primarily due to decreases in securities and loans. Partially offsetting this decrease was a \$26.2 million, or 44.1%, increase in cash and cash equivalents to \$85.6 million at June 30, 2016, from \$59.4 million at December 31, 2015.

Loans decreased \$24.7 million, or 2.0%, to \$1.208 billion at June 30, 2016, from \$1.232 billion at December 31, 2015. The decrease was due in part to our sale of three performing loans to a single borrower with a total carrying value of \$16.2 million in the second quarter of 2016. At June 30, 2016, our loan portfolio consisted of \$845.5 million of real estate loans, which represented 69.6% of total loans. The Bank's primary lending area consists of the counties in the State of Illinois where our branch offices are located, and contiguous counties. We derive the most significant portion

of our revenues from these geographic areas. We also engage in multi-family lending activities in carefully selected metropolitan areas outside our primary lending area, and engage in certain types of commercial lending and leasing activities on a nationwide basis. At June 30, 2016, \$294.7 million, or 58.5%, of

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our multi-family loans were in the Metropolitan Statistical Area for Chicago, Illinois, while \$52.1 million, or 10.3%, were in the Metropolitan Statistical Area for Dallas, Texas, \$54.0 million, or 10.7%, were in the Metropolitan Statistical Area for Denver, Colorado, \$20.9 million, or 4.1%, were in the Metropolitan Statistical Area for Minneapolis, Minnesota, and \$16.1 million, or 3.2%, were in the Metropolitan Statistical Area for Tampa, Florida. This information reflects the location of the collateral, but does not necessarily reflect the location of the borrower. Total liabilities decreased \$7.0 million, or 0.5%, to \$1.293 billion at June 30, 2016, from \$1.300 billion at December 31, 2015, primarily due to decreases in borrowings, non-interest demand accounts and money market accounts, which were partially offset by increases in savings accounts, interest-bearing NOW accounts and certificates of deposits. Total deposits increased \$55.7 million, or 4.6%, to \$1.269 billion at June 30, 2016, from \$1.213 billion at December 31, 2015. Certificates of deposit increased \$81.6 million, or 36.6%, to \$304.3 million at June 30, 2016, from \$222.7 million at December 31, 2015. This increase included a \$68.7 million increase in brokered certificates of deposit. Savings accounts increased \$1.9 million, or 1.2%, to \$158.7 million at June 30, 2016, from \$156.8 million at December 31, 2015. Noninterest-bearing demand deposits decreased \$22.9 million, or 9.0%, to \$231.9 million at June 30, 2016, from \$254.8 million at December 31, 2015. Money market and interest-bearing NOW accounts decreased \$4.9 million, or 0.9%, to \$573.7 million at June 30, 2016, from \$578.6 million at December 31, 2015. Core deposits (savings, money market, noninterest-bearing demand and NOW accounts) were 76.0% and 81.6% of total deposits at June 30, 2016 and December 31, 2015, respectively. Total stockholders' equity was \$206.7 million at June 30, 2016, compared to \$212.4 million at December 31, 2015. The decrease in total stockholders' equity was primarily due to the combined impact of our repurchase of 618,620 shares of our common stock at a total cost of \$7.7 million, and our declaration and payment of cash dividends totaling \$2.0 million, during the six months ended June 30, 2016. These items were partially offset by the net income of \$2.7 million that we recorded for the six months ended June 30, 2016. The unallocated shares of common stock that our ESOP owns were reflected as an \$8.8 million reduction to stockholders' equity at June 30, 2016, compared to a \$9.3 million reduction at December 31, 2015.

Operating Results for the Three Months Ended June 30, 2016 and 2015

Net Income. We had net income of \$831,000 for the three months ended June 30, 2016, compared to net income \$2.2 million for the three months ended June 30, 2015. The decline in net income was due in part to a pre-tax charge off of \$1.6 million resulting from our decision to sell three performing loans to a single borrower with a total carrying value of \$16.2 million. Earnings per basic and fully diluted share of common stock were \$0.04 for the three months ended June 30, 2016, compared to \$0.11 for the three months ended June 30, 2015.

Net Interest Income. Net interest income was \$11.6 million for the three months ended June 30, 2016, compared to \$11.5 million for the same period in 2015. The increase in net interest income reflected a \$388,000, or 3.2%, increase in interest income, which was partially offset by a \$261,000, or 37.8%, increase in interest expense.

The increase in interest income was primarily attributable to increases in net average interest-earning assets, which were partially offset by a decrease in the yield on interest-earning assets. Total average interest-earning assets increased \$65.4 million, or 4.85%, to \$1.413 billion for the three months ended June 30, 2016, from \$1.348 billion for the same period in 2015. Our net interest rate spread decreased by 15 basis points to 3.21% for the three months ended June 30, 2016, from 3.36% for the same period in 2015. Our net interest margin decreased by 11 basis points to 3.31% for the three months ended June 30, 2016, from 3.42% for the same period in 2015. The decreases in the net interest rate spread and net interest margin resulted from increased average balances, which were partially offset by lower yields on interest-earning assets and increased costs for interest-bearing liabilities. The yield on interest-earning assets decreased five basis points to 3.58% for the three months ended June 30, 2016, from 3.63% for the same period in 2015, and the cost of interest-bearing liabilities increased ten basis points to 0.37% for the three months ended June 30, 2016, from 0.27% for the same period in 2015.

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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 June 30,						
	2016			2015			
	Average			Average			
	Outstanding	Interest	Yield/Rate	Outstanding	Interest	Yield/Rate	
	Balance		(1)	Balance		(1)	
	(Dollars in thousands)						
Interest-earning assets:							
Loans	\$ 1,210,726	\$ 12,099	4.02	%	\$ 1,150,417	\$ 11,836	4.13
Securities	108,865	307	1.13		107,697	257	0.96
Stock in FHLBC	6,257	29	1.86		6,257	8	0.51
Other	87,313	146	0.67		83,439	92	0.44
Total interest-earning assets	1,413,161	12,581	3.58		1,347,810	12,193	3.63
Noninterest-earning assets	96,954				101,930		
Total assets	\$ 1,510,115				\$ 1,449,740		
Interest-bearing liabilities:							
Savings deposits	\$ 160,673	43	0.11		\$ 158,318	41	0.10
Money market accounts	320,232	246	0.31		339,281	266	0.31
NOW accounts	251,465	92	0.15		295,390	91	0.12
Certificates of deposit	302,304	569	0.76		229,672	291	0.51
Total deposits	1,034,674	950	0.37		1,022,661	689	0.27
Borrowings	3,107	2	0.26		2,883	2	0.28
Total interest-bearing liabilities	1,037,781	952	0.37		1,025,544	691	0.27
Noninterest-bearing deposits	240,358				185,969		
Noninterest-bearing liabilities	22,745				23,114		
Total liabilities	1,300,884				1,234,627		
Equity	209,231				215,113		
Total liabilities and equity	\$ 1,510,115				\$ 1,449,740		
Net interest income		\$ 11,629				\$ 11,502	
Net interest rate spread (2)			3.21	%			3.36
Net interest-earning assets (3)	\$ 375,380				\$ 322,266		
Net interest margin (4)			3.31	%			3.42
Ratio of interest-earning assets to interest-bearing liabilities	136.17	%			131.42	%	

(1) Annualized

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

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

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

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Provision for Loan Losses

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

We recorded a provision for loan losses of \$1.3 million for the three months ended June 30, 2016, compared to a recovery of loan losses of \$488,000 for the same period in 2015. 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 \$525,000, or 5.6%, to \$8.8 million at June 30, 2016, from \$9.4 million at March 31, 2016. The reserve established for loans individually evaluated for impairment increased \$24,000, or 42.1%, to \$81,000 for the three months ended June 30, 2016. Net charge-offs were \$1.8 million for the three months ended June 30, 2016.

Net charge-offs included a \$1.6 million charge-off resulting from the Company's sale of three performing loans to a single borrower with a total carrying value of \$16.2 million on June 22, 2016. The loans were previously discussed in the "Nonperforming Assets" section of the Company's Quarterly Report on Form 10-Q for the third quarter of 2015 and in a Current Report on Form 8-K that the Company filed with the SEC on June 22, 2016. Although the loans were well-secured and supported by adequate cash flow, the Company concluded that possible future events could increase the risk of a default and subject the Company to significant legal expenses and an extended resolution period. The Company therefore elected to pursue a resolution that would result in a finite, known consequence rather than alternative resolution strategies that presented multiple uncertainties and risks that were difficult to quantify.

The allowance for loan losses as a percentage of nonperforming loans was 170.52% at June 30, 2016, compared to 173.69% at March 31, 2016.

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.

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Noninterest Income

	Three Months Ended June 30,		
	2016	2015	Change
	(Dollars in thousands)		
Deposit service charges and fees	\$541	\$532	\$9
Other fee income	505	601	(96)
Insurance commissions and annuities income	72	86	(14)
Gain on sale of loans, net	3	28	(25)
Loss on disposition of premises and equipment	—	(1)	1
Loan servicing fees	75	96	(21)
Amortization of servicing assets	(40)	(35)	(5)
Recovery of servicing assets	3	3	—
Earnings on bank owned life insurance	46	45	1
Trust income	165	183	(18)
Other	167	151	16
Total noninterest income	\$1,537	\$1,689	\$(152)

Noninterest income decreased \$152,000, or 9.0%, to \$1.5 million for the three months ended June 30, 2016, compared to \$1.7 million for the three months ended June 30, 2015. Other fee income decreased \$96,000, or 16.0%, to \$505,000 for the three months ended June 30, 2016, compared to \$601,000 for the three months ended June 30, 2015. The decrease reflects decreased ATM charges and other loan fees. Noninterest income for the three months ended June 30, 2016 included a \$3,000 gain on sale of loans, compared to a \$28,000 gain on sale of loans for the same period in 2015. Loan servicing fees decreased \$21,000 due to a decrease in the balance of loans serviced for others.

Noninterest Expense

	Three Months Ended June 30,		
	2016	2015	Change
	(Dollars in thousands)		
Compensation and benefits	\$5,713	\$5,278	\$435
Office occupancy and equipment	1,635	1,670	(35)
Advertising and public relations	252	227	25
Information technology	699	657	42
Supplies, telephone and postage	297	385	(88)
Amortization of intangibles	129	136	(7)
Nonperforming asset management	127	108	19
Gain on sale other real estate owned	(38)	(22)	(16)
Valuation adjustments of other real estate owned	10	23	(13)
Operations of other real estate owned	177	91	86
FDIC insurance premiums	236	262	(26)
Other	1,269	1,216	53
Total noninterest expense	\$10,506	\$10,031	\$475

Noninterest expense increased by \$475,000, or 4.7%, to \$10.5 million for the three months ended June 30, 2016, from \$10.0 million for the same period in 2015. The increase was due in substantial part to a \$435,000, or 8.2%, increase in compensation and benefits expense, which included \$391,000 in stock-based compensation expense, compared to \$17,000 in stock-based compensation expense for the same period in 2015. Advertising and public relations expense increased \$25,000, or 11.0%, to \$252,000 for the three months ended June 30, 2016, from \$227,000 for the same

period in 2015. The increase reflects additional advertising and

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marketing expenses relating to commercial lending, particularly national health care lending. Nonperforming asset management expense increased \$19,000, or 17.6%, to \$127,000 for the three months ended June 30, 2016, from \$108,000 for the same period in 2015, primarily due to increased repair and maintenance expenses, which were partially offset by lower legal expenses and receiver fees. Operations of other real estate owned increased \$86,000, to \$177,000 for the three months ended June 30, 2016, compared to \$91,000 for the same period in 2015. The increase reflects a \$155,000 decrease in rental income and a \$24,000 increase in repair and maintenance expense, which were partially offset by a \$102,000 decrease in receiver fees. Other expenses included a \$20,000 increase in the mortgage representation and warranty reserve for mortgage loans sold, compared to a loss of \$68,000 recorded in 2015 for a loan serviced for others. The amount of the warranty and representation reserve was calculated by applying published Fannie Mae data relating to the percentage of loans that it required to be repurchased due to breaches of warranties and representations to the Bank's outstanding sold loans.

Income Taxes

For the three months ended June 30, 2016, we recorded income tax expense of \$514,000, compared to \$1.4 million for the three months ended June 30, 2015. Our effective tax rate for the three months ended June 30, 2016 was 38.2%, compared to 39.0% for the same period in 2015.

Operating Results for the Six Months Ended June 30, 2016 and 2015

Net Income. We had net income of \$2.7 million for the six months ended June 30, 2016, compared to \$4.2 million for the six months ended June 30, 2015. The decline in net income was due in part to a pre-tax charge off of \$1.6 million resulting from our decision to sell three performing loans to a single borrower with a total carrying value of \$16.2 million in the second quarter of 2016. Our earnings per basic and fully diluted share of common stock was \$0.14 for the six months ended June 30, 2016, compared to \$0.21 per basic and fully diluted share for the same period in 2015.

Net Interest Income. Net interest income was \$23.5 million for the six months ended June 30, 2016, compared to \$23.0 million for the same period in 2015. The increase in net interest income reflected a \$936,000 increase in interest income which was partially offset by a \$431,000 increase in interest expense.

The increase in net interest income was primarily attributable to an increase in net average interest-earning assets, which was partially offset by the decrease in average interest-bearing liabilities and a decrease in the yield on interest-earning assets. Total average interest-earning assets increased \$67.3 million, or 5.0%, to \$1.414 billion for the six months ended June 30, 2016, from \$1.346 billion for the same period in 2015. Our net interest rate spread decreased by 15 basis points to 3.25% for the six months ended June 30, 2016, from 3.40% for the same period in 2015. Our net interest margin decreased by ten basis point to 3.35% for the six months ended June 30, 2016, from 3.45% for the same period in 2015. The decreases in the net interest spread and net interest margin resulted from increased average interest-earning assets at lower yields and increased costs for interest-bearing liabilities. The yield on interest-earning assets decreased six basis point to 3.60% for the six months ended June 30, 2016, from 3.66% for the same period in 2015, and the cost of interest-bearing liabilities increased nine basis points to 0.35% for the six months ended June 30, 2016, from 0.26% for the same period in 2015.

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Average Balance Sheets

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

	For the Six Months Ended June 30,							
	2016		2015		2016		2015	
	Average		Average		Average		Average	
	Outstanding	Interest	Yield/Rate	(1)	Outstanding	Interest	Yield/Rate	(1)
	Balance				Balance			
	(Dollars in thousands)							
Interest-earning assets:								
Loans	\$1,224,422	\$24,446	4.02	%	\$1,157,224	\$23,659	4.12	%
Securities	113,684	621	1.10		114,788	584	1.03	
Stock in FHLBC	6,257	43	1.38		6,257	16	0.52	
Other	69,189	230	0.67		67,941	145	0.43	
Total interest-earning assets	1,413,552	25,340	3.60		1,346,210	24,404	3.66	
Noninterest-earning assets	98,341				102,822			
Total assets	\$1,511,893				\$1,449,032			
Interest-bearing liabilities:								
Savings deposits	\$159,503	85	0.11		\$157,092	80	0.10	
Money market accounts	322,363	495	0.31		339,971	536	0.32	
NOW accounts	248,307	183	0.15		321,222	179	0.11	
Certificates of deposit	268,774	974	0.73		230,178	578	0.51	
Total deposits	998,947	1,737	0.35		1,048,463	1,373	0.26	
Borrowings	38,809	71	0.37		3,021	4	0.27	
Total interest-bearing liabilities	1,037,756	1,808	0.35		1,051,484	1,377	0.26	
Noninterest-bearing deposits	241,323				158,158			
Noninterest-bearing liabilities	22,047				22,615			
Total liabilities	1,301,126				1,232,257			
Equity	210,767				216,775			
Total liabilities and equity	\$1,511,893				\$1,449,032			
Net interest income		\$23,532				\$23,027		
Net interest rate spread (2)			3.25	%			3.40	%
Net interest-earning assets (3)	\$375,796				\$294,726			