

BankFinancial CORP  
Form 10-Q  
October 25, 2017

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

FORM 10-Q

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

For the Quarterly Period ended September 30, 2017

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, former address and former fiscal year, 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, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☒

Non-accelerated filer ☐ Smaller reporting company ☐

Emerging growth company ☐

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. "

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date. At October 23, 2017, there were 18,049,423 shares of Common Stock, \$0.01 par value, outstanding.

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BANKFINANCIAL CORPORATION

Form 10-Q

September 30, 2017

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

	September 30, 2017	December 31, 2016
<b>Assets</b>		
Cash and due from other financial institutions	\$ 10,620	\$ 13,053
Interest-bearing deposits in other financial institutions	115,041	83,631
Cash and cash equivalents	125,661	96,684
Securities, at fair value	98,787	107,212
Loans receivable, net of allowance for loan losses:		
September 30, 2017, \$8,374 and December 31, 2016, \$8,127	1,335,631	1,312,952
Other real estate owned, net	3,569	3,895
Stock in Federal Home Loan Bank and Federal Reserve Bank, at cost	8,290	11,650
Premises and equipment, net	30,774	31,413
Accrued interest receivable	4,569	4,381
Core deposit intangible	408	782
Bank owned life insurance	22,790	22,594
Deferred taxes	20,214	22,411
Other assets	3,576	6,063
Total assets	\$ 1,654,269	\$ 1,620,037
<b>Liabilities</b>		
Deposits		
Noninterest-bearing	\$ 231,049	\$ 249,539
Interest-bearing	1,140,040	1,089,851
Total deposits	1,371,089	1,339,390
Borrowings	60,928	51,069
Advance payments by borrowers for taxes and insurance	10,683	11,041
Accrued interest payable and other liabilities	11,791	13,757
Total liabilities	1,454,491	1,415,257
<b>Stockholders' equity</b>		
Preferred Stock, \$0.01 par value, 25,000,000 shares authorized, none issued or outstanding	—	—
Common Stock, \$0.01 par value, 100,000,000 shares authorized; 18,063,623 shares issued at September 30, 2017 and 19,233,760 issued at December 31, 2016	180	192
Additional paid-in capital	155,481	173,047
Retained earnings	43,786	39,483
Unearned Employee Stock Ownership Plan shares	—	(8,318 )
Accumulated other comprehensive income	331	376
Total stockholders' equity	199,778	204,780
Total liabilities and stockholders' equity	\$ 1,654,269	\$ 1,620,037

See accompanying notes to the consolidated financial statements.



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## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Interest and dividend income				
Loans, including fees	\$ 13,345	\$ 12,388	\$ 39,061	\$ 36,834
Securities	389	306	1,095	927
Other	387	151	976	424
Total interest income	14,121	12,845	41,132	38,185
Interest expense				
Deposits	1,419	1,012	3,903	2,749
Borrowings	196	2	444	73
Total interest expense	1,615	1,014	4,347	2,822
Net interest income	12,506	11,831	36,785	35,363
Provision for (recovery of) loan losses	(225 )	(525 )	(15 )	300
Net interest income after provision for (recovery of) loan losses	12,731	12,356	36,800	35,063
Noninterest income				
Deposit service charges and fees	584	583	1,682	1,691
Other fee income	523	478	1,494	1,478
Insurance commissions and annuities income	41	53	170	180
Gain on sale of loans, net	10	38	70	59
Gain on sale of securities (includes \$46 accumulated other comprehensive income reclassifications for unrealized net gains on available for sale securities for the nine months ended September 30, 2016)	—	—	—	46
Loan servicing fees	58	66	188	214
Amortization and impairment of servicing assets	(27 )	(28 )	(86 )	(96 )
Earnings on bank owned life insurance	67	54	196	151
Trust income	169	167	534	492
Other	198	226	526	553
Total noninterest income	1,623	1,637	4,774	4,768
Noninterest expense				
Compensation and benefits	5,330	5,315	16,792	17,021
Office occupancy and equipment	1,693	1,487	4,914	4,769
Advertising and public relations	167	144	807	618
Information technology	638	707	2,070	2,130
Supplies, telephone, and postage	337	345	1,027	1,018
Amortization of intangibles	123	129	374	394
Nonperforming asset management	84	89	215	300
Operations of other real estate owned	403	243	861	768
FDIC insurance premiums	150	238	462	691
Other	1,275	1,215	3,551	3,639
Total noninterest expense	10,200	9,912	31,073	31,348
Income before income taxes	4,154	4,081	10,501	8,483
Income tax expense	594	1,573	2,488	3,240
Net income	\$ 3,560	\$ 2,508	\$ 8,013	\$ 5,243
Basic earnings per common share	\$ 0.20	\$ 0.13	\$ 0.44	\$ 0.27

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Diluted earnings per common share	\$0.20	\$ 0.13	\$0.44	\$ 0.27
Weighted average common shares outstanding	18,139,659	18,788,731	18,368,742	19,114,603
Diluted weighted average common shares outstanding	18,140,109	18,789,054	18,369,170	19,114,918

See accompanying notes to the consolidated financial statements.

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## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands) - Unaudited

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income	\$3,560	\$2,508	\$8,013	\$5,243
Unrealized holding gain (loss) arising during the period	16	(13 )	(67 )	(75 )
Tax effect	(9 )	5	22	29
Net of tax	7	(8 )	(45 )	(46 )
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 income (loss)	7	(8 )	(45 )	(74 )
Comprehensive income	\$3,567	\$2,500	\$7,968	\$5,169

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
Balance at January 1, 2016	\$ 203	\$ 184,797	\$ 36,114	\$ (9,297 )	\$ 547	\$ 212,364
Net income	—	—	5,243	—	—	5,243
Other comprehensive loss, net of tax	—	—	—	—	(74 )	(74 )
Repurchase and retirement of common stock (1,026,106 shares)	(10 )	(12,685 )	—	—	—	(12,695 )
Nonvested stock awards-stock-based compensation expense	—	875	—	—	—	875
Cash dividends declared on common stock (\$0.15 per share)	—	—	(2,977 )	—	—	(2,977 )
ESOP shares earned	—	198	—	733	—	931
Balance at September 30, 2016	\$ 193	\$ 173,185	\$ 38,380	\$ (8,564 )	\$ 473	\$ 203,667
Balance at January 1, 2017	\$ 192	\$ 173,047	\$ 39,483	\$ (8,318 )	\$ 376	\$ 204,780
Net income	—	—	8,013	—	—	8,013
Other comprehensive loss, net of tax	—	—	—	—	(45 )	(45 )
Net exercise of stock options (198,026 shares)	2	(1,239 )	—	—	—	(1,237 )
Prepayment of ESOP Share Acquisition Loan	(8 )	(7,185 )	—	8,318	—	1,125
Repurchase and retirement of common stock (614,673 shares)	(6 )	(9,142 )	—	—	—	(9,148 )
Cash dividends declared on common stock (\$0.20 per share)	—	—	(3,710 )	—	—	(3,710 )
Balance at September 30 , 2017	\$ 180	\$ 155,481	\$ 43,786	\$ —	\$ 331	\$ 199,778

See accompanying notes to the consolidated financial statements.

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

	Nine Months Ended September 30, 2017      2016	
Cash flows from operating activities		
Net income	\$8,013	\$5,243
Adjustments to reconcile to net income to net cash from operating activities		
Provision for (recovery of) loan losses	(15 )	300
Prepayment of ESOP Share Acquisition Loan	1,125	—
ESOP shares earned	—	931
Stock-based compensation expense	—	875
Depreciation and amortization	2,846	2,815
Amortization of premiums and discounts on securities and loans	(72 )	(104 )
Amortization of core deposit intangible	374	394
Amortization of servicing assets	86	96
Net change in net deferred loan origination costs	343	(36 )
Net gain (loss) on sale of other real estate owned	100	(15 )
Net gain on sale of loans	(70 )	(59 )
Net gain on sale of securities	—	(46 )
Loans originated for sale	(1,291 )	(1,097 )
Proceeds from sale of loans	1,361	1,156
Other real estate owned valuation adjustments	301	244
Net change in:		
Accrued interest receivable	(188 )	70
Earnings on bank owned life insurance	(196 )	(151 )
Other assets	4,027	3,515
Accrued interest payable and other liabilities	(1,966 )	(1,279 )
Net cash from operating activities	14,778	12,852
Cash flows from investing activities		
Securities		
Proceeds from maturities	49,695	58,577
Proceeds from principal repayments	2,461	3,545
Proceeds from sales of securities	—	46
Purchases of securities	(43,808)	(47,423)
Loans receivable		
Loan participations sold	3,615	3,023
Principal payments on loans receivable	459,706	366,784
Purchase of loans	(23,451)	—
Proceeds of loan sale	—	14,746
Originated for investment	(465,562)	(395,087)
Proceeds of redemption of Federal Home Loan Bank of Chicago stock	3,514	—
Purchase of Federal Home Loan Bank and Federal Reserve Bank stock	(154 )	—
Proceeds from sale of other real estate owned	1,966	2,616
Purchase of premises and equipment, net	(906 )	(660 )

Net cash from (used in) investing activities	(12,924) 6,167
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BANKFINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands) - Unaudited

	Nine Months Ended September 30,	
	2017	2016
Cash flows from financing activities		
Net change in deposits	\$31,699	\$103,776
Net change in borrowings	9,859	(62,912 )
Net change in advance payments by borrowers for taxes and insurance	(358 )	(3,058 )
Repurchase and retirement of common stock	(9,148 )	(12,695 )
Cash dividends paid on common stock	(3,710 )	(2,977 )
Shares retired for tax liability	(1,219 )	—
Net cash from financing activities	27,123	22,134
Net change in cash and cash equivalents	28,977	41,153
Beginning cash and cash equivalents	96,684	59,377
Ending cash and cash equivalents	\$125,661	\$100,530
Supplemental disclosures of cash flow information:		
Interest paid	\$4,269	\$2,704
Income taxes paid	198	182
Loans transferred to other real estate owned	2,041	215

See accompanying notes to the consolidated financial statements.

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation: BankFinancial Corporation, a Maryland corporation headquartered in Burr Ridge, Illinois (the “Company”), is the owner of all of the issued and outstanding capital stock of BankFinancial, National Association (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 nine-month periods ended September 30, 2017 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2017.

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, 2016, 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 become effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. We have evaluated the impact of adopting the new guidance on the consolidated financial statements. Our finding is that the new pronouncement will not have a significant impact on the consolidated financial statements as the majority of our business transactions will not be subject to this pronouncement.

In January 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 have evaluated the impact of adopting the new guidance on the consolidated financial statements. Our finding is that the new pronouncement will not have a significant impact on our Statement of Operations.

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 (continued)

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. Our preliminary finding is that the new pronouncement will not have a significant impact on our consolidated financial statements as the projected minimum lease payments under existing leases subject to the new pronouncement are less than one percent of our current total assets.

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 was effective January 1, 2017. This new pronouncement affects the effective tax rate reported as existing vested stock options are exercised. The amount of the impact on the effective tax rate is determined by the number of stock options exercised and the stock price of the Company when the stock options are exercised. Excess tax benefits and deficiencies are recorded in the tax expense.

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. Our initial review indicates that we have maintained sufficient historical loan data to support the requirements of this pronouncement. In addition, we have begun tracking the average life of the various segments of our loan portfolio. We are currently evaluating various loss methodologies to determine their correlation to our various loan categories' historical performance.

In March of 2017, the FASB issued ASU No. 2017-08, "Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities" ("ASU 2017-08"). This guidance shortens the amortization period for premiums on certain callable debt securities to the earliest call date (with an explicit, noncontingent call feature that is callable at a fixed price and on a preset dates), rather than contractual maturity date as currently required under GAAP. The ASU does not impact instruments without preset call dates such as mortgage-backed securities. For instruments with contingent call features, once the contingency is resolved and the security is callable at a fixed price and preset date, the security is within the scope of the ASU. ASU 2017-08 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, and early adoption is permitted. Effective January 2017, we early adopted the pronouncement. Adoption of the new pronouncement was immaterial 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 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 BankFinancial, NA Employee Stock Ownership Plan (the "ESOP") shares and unvested restricted stock shares. Stock options and restricted stock are regarded as potential common stock and are considered in the diluted earnings per share calculations to the extent that they would have a dilutive effect if converted to common stock.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income available to common stockholders	\$3,560	\$ 2,508	\$8,013	\$ 5,243
Average common shares outstanding	18,140,599	19,460,022	18,567,790	19,813,088
Less:				
Unearned ESOP shares	—	(670,351 )	(198,114 )	(694,655 )
Unvested restricted stock shares	(940 )	(940 )	(940 )	(3,830 )
Weighted average common shares outstanding	18,139,659	18,788,731	18,368,740	19,114,603
Add - Net effect of dilutive unvested restricted stock	450	323	428	315
Diluted weighted average common shares outstanding	18,140,109	19,112,054	18,369,168	19,428,918
Basic earnings per common share	\$0.20	\$ 0.13	\$0.44	\$ 0.27
Diluted earnings per common share	\$0.20	\$ 0.13	\$0.44	\$ 0.27
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

## NOTE 3 - SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2017				
Certificates of deposit	\$ 80,360	\$ —	\$ —	\$80,360
Equity mutual fund	500	2	—	502
Mortgage-backed securities - residential	12,645	553	(10 )	13,188
Collateralized mortgage obligations - residential	4,728	14	(17 )	4,725
SBA-guaranteed loan participation certificates	12	—	—	12
	\$ 98,245	\$ 569	\$ (27 )	\$ 98,787
December 31, 2016				
Certificates of deposit	\$ 85,938	\$ —	\$ —	\$85,938
Equity mutual fund	500	—	(1 )	499
Mortgage-backed securities - residential	14,561	644	(21 )	15,184
Collateralized mortgage obligations - residential	5,587	15	(28 )	5,574
SBA-guaranteed loan participation certificates	17	—	—	17
	\$ 106,603	\$ 659	\$ (50 )	\$ 107,212





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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 3 - SECURITIES (continued)

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 September 30, 2017 and December 31, 2016.

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

	September 30, 2017	
	Amortized Cost	Fair Value
Due in one year or less	\$80,360	\$80,360
Equity mutual fund	500	502
Mortgage-backed securities - residential	12,645	13,188
Collateralized mortgage obligations - residential	4,728	4,725
SBA-guaranteed loan participation certificates	12	12
	\$98,245	\$98,787

Sales of securities were as follows:

	Three Months Ended September 30, 2017		Nine Months Ended September 30, 2016	
Proceeds	\$ —	\$ —	\$ —	\$ 46
Gross gains	—	—	—	46

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

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
September 30, 2017						
Mortgage-backed securities - residential	\$1,182	\$ (10 )	\$ —	\$ —	\$1,182	\$ (10 )
Collateralized mortgage obligations - residential	—	—	3,270	(17 )	3,270	(17 )
	\$1,182	\$ (10 )	\$3,270	\$ (17 )	\$4,452	\$ (27 )
December 31, 2016						
Equity Mutual Fund	\$499	\$ (1 )	\$ —	\$ —	\$499	\$ (1 )
Mortgage-backed securities - residential	1,187	(21 )	—	—	1,187	(21 )
Collateralized mortgage obligations - residential	3,691	(18 )	1,028	(10 )	4,719	(28 )
	\$5,377	\$ (40 )	\$1,028	\$ (10 )	\$6,405	\$ (50 )

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



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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 3 - SECURITIES (continued)

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 mortgage-backed securities and collateralized mortgage obligations that the Company holds in its investment portfolio were in an unrealized loss position at September 30, 2017, 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:

	September 30, 2017	December 31, 2016
One-to-four family residential real estate	\$ 105,186	\$ 135,218
Multi-family mortgage	576,425	542,887
Nonresidential real estate	176,301	182,152
Construction and land	2,827	1,302
Commercial loans	147,079	103,063
Commercial leases	333,120	352,539
Consumer	1,747	2,255
	1,342,685	1,319,416
Net deferred loan origination costs	1,320	1,663
Allowance for loan losses	(8,374)	(8,127)
Loans, net	\$ 1,335,631	\$ 1,312,952

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	Individually evaluated for impairment	Collectively evaluated for impairment	Total
September 30, 2017					
One-to-four family residential real estate	\$—	\$ 812	\$ 4,616	\$ 100,570	\$ 105,186
Multi-family mortgage	—	3,872	959	575,466	576,425
Nonresidential real estate	—	1,590	—	176,301	176,301
Construction and land	—	68	—	2,827	2,827
Commercial loans	—	1,241	—	147,079	147,079
Commercial leases	—	769	—	333,120	333,120
Consumer	—	22	—	1,747	1,747
	\$—	\$ 8,374	\$ 5,575	\$ 1,337,110	1,342,685
Net deferred loan origination costs					1,320
Allowance for loan losses					(8,374)
Loans, net					\$ 1,335,631



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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

	Allowance for loan losses			Loan Balances		
	Individually evaluated for impairment	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Collectively evaluated for impairment	Total
December 31, 2016						
One-to-four family residential real estate	\$—	\$ 1,168	\$ 1,168	\$ 4,962	\$ 130,256	\$ 135,218
Multi-family mortgage	—	3,647	3,647	787	542,100	542,887
Nonresidential real estate	26	1,768	1,794	260	181,892	182,152
Construction and land	—	32	32	—	1,302	1,302
Commercial loans	—	733	733	—	103,063	103,063
Commercial leases	—	714	714	—	352,539	352,539
Consumer	—	39	39	—	2,255	2,255
	\$ 26	\$ 8,101	\$ 8,127	\$ 6,009	\$ 1,313,407	\$ 1,319,416
Net deferred loan origination costs						1,663
Allowance for loan losses						(8,127 )
Loans, net						\$ 1,312,952

Activity in the allowance for loan losses is as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Beginning balance	\$8,122	\$8,915	\$8,127	\$9,691
Loans charged off:				
One-to-four family residential real estate	(89 )	(102 )	(282 )	(509 )
Multi-family mortgage	(7 )	—	(10 )	(51 )
Nonresidential real estate	—	(55 )	(165 )	(1,715 )
Consumer	(7 )	(6 )	(7 )	(24 )
	(103 )	(163 )	(464 )	(2,299 )
Recoveries:				
One-to-four family residential real estate	15	5	100	92
Multi-family mortgage	11	10	62	156
Nonresidential real estate	10	39	10	200
Construction and land	—	—	—	35
Commercial loans	542	45	552	150
Commercial leases	2	7	2	7
Consumer	—	1	—	2
	580	107	726	642
Net recoveries (charge-offs)	477	(56 )	262	(1,657 )
Provision for (recovery of) loan losses	(225 )	(525 )	(15 )	300
Ending balance	\$8,374	\$8,334	\$8,374	\$8,334







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One-to-four family residential real estate - non-owner occupied	503	386	119	—	251	9
Multi-family mortgage - Illinois	787	787	—	—	980	41
	6,669	5,721	1,005	—	4,178	120
With an allowance recorded:						
Nonresidential real estate	262	260	21	26	164	—
	262	260	21	26	164	—
	\$ 6,931	\$ 5,981	\$ 1,026	\$ 26	\$ 4,342	\$ 120

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

## Nonaccrual Loans

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

	Loan Balance	Recorded Investment	Loans Past Due Over 90 Days, Still Accruing
September 30, 2017			
One-to-four family residential real estate	\$ 3,392	\$ 1,658	\$ —
One-to-four family residential real estate – non-owner occupied	751	576	—
Multi-family mortgage - Illinois	378	371	—
	\$ 4,521	\$ 2,605	\$ —
December 31, 2016			
One-to-four family residential real estate	\$ 2,861	\$ 2,483	\$ —
One-to-four family residential real estate – non-owner occupied	428	368	—
Multi-family mortgage - Illinois	187	185	—
Nonresidential real estate	262	260	—
	\$ 3,738	\$ 3,296	\$ —

Nonaccrual loans and impaired loans are defined differently. Some loans may be included in both categories, and some loans 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 \$250,000 and \$199,000 at September 30, 2017 and December 31, 2016, 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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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

## Past Due Loans

The following tables present the aging of the recorded investment of loans at September 30, 2017 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	\$ 749	\$ 1,655	\$ 2,498	\$ 79,800	\$ 82,298
One-to-four family residential real estate loans – non-owner occupied	12	3	577	592	22,321	22,913
Multi-family mortgage - Illinois	—	—	371	371	288,508	288,879
Multi-family mortgage - Other	—	—	—	—	281,887	281,887
Nonresidential real estate	—	—	—	—	174,724	174,724
Construction	—	—	—	—	2,548	2,548
Land	—	—	—	—	281	281
Commercial loans:						
Regional commercial banking	—	—	—	—	40,315	40,315
Health care	—	—	—	—	72,685	72,685
Direct commercial lessor	275	369	—	644	33,787	34,431
Commercial leases:						
Investment rated commercial leases	—	2,225	—	2,225	230,009	232,234
Other commercial leases	—	—	—	—	102,698	102,698
Consumer	—	—	—	—	1,754	1,754
	\$ 381	\$ 3,346	\$ 2,603	\$ 6,330	\$ 1,331,317	\$ 1,337,647

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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, 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	\$ 984	\$ 335	\$ 2,235	\$ 3,554	\$ 92,665	\$ 96,219
One-to-four family residential real estate loans – non-owner occupied	664	114	368	1,146	37,179	38,325
Multi-family mortgage - Illinois	605	439	184	1,228	294,223	295,451
Multi-family mortgage - Other	—	—	—	—	243,944	243,944
Nonresidential real estate	—	—	260	260	178,644	178,904
Construction	—	—	—	—	950	950
Land	—	—	—	—	349	349
Commercial loans:						
Regional commercial banking	—	—	—	—	26,480	26,480
Health care	—	—	—	—	41,086	41,086
Direct commercial lessor	—	—	—	—	31,847	31,847
Commercial leases:						
Investment rated commercial leases	51	—	—	51	273,405	273,456
Other commercial leases	—	—	—	—	84,988	84,988
Consumer	—	—	—	—	2,263	2,263
	\$ 2,304	\$ 888	\$ 3,047	\$ 6,239	\$ 1,308,023	\$ 1,314,262

## 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 \$17,000 of TDRs at September 30, 2017, compared to \$341,000 at December 31, 2016. No specific valuation reserves were allocated to those loans at September 30, 2017 and December 31, 2016. The Company had no outstanding commitments to borrowers whose loans were classified as TDRs at either date.

The following table presents loans classified as TDRs:

	September 30, 2017	December 31, 2016
One-to-four family residential real estate	\$ —	\$ 205
Troubled debt restructured loans – accrual loans	—	205
One-to-four family residential real estate	17	136
Troubled debt restructured loans – nonaccrual loans	17	136
Total troubled debt restructured loans	\$ 17	\$ 341

During the nine months ended September 30, 2017, there were no loans modified and classified as TDRs. During the nine months ended September 30, 2016, 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

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

The following tables present TDR activity:

	For the Nine Months Ended September 30, 2017		2016	
	Pre-Modification Number of outstanding loans recorded investment	Post-Modification Modification outstanding recorded investment	Pre-Modification Number of outstanding loans recorded investment	Post-Modification Modification outstanding recorded investment
One-to-four family residential real estate	—\$	—\$	—1 \$ 63	\$ 63
		Due to reduction in interest rate	Due to extension of maturity date	Due to permanent reduction in recorded investment

For the Nine Months Ended September 30, 2016

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 nine months ended September 30, 2016.

The following table presents TDRs for which there was a payment default during the nine months ended September 30, 2017 and 2016 within twelve months following the modification.

	2017	2016
	Number of Recorded investment loans	Number of Recorded investment loans
One-to-four family residential real estate	1 \$ 17	2 \$ 87

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

The TDRs for which there was a payment default resulted in no change to the allowance for loan losses allocated and resulted in no charge-offs during the nine months ended September 30, 2017 and 2016.

There were certain other loan modifications during the three and nine months ended September 30, 2017 and 2016 that did not meet the definition of a TDR. These loans had a total recorded investment of \$149,000 and \$615,000 at September 30, 2017 and 2016, respectively. The modification of these loans involved either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

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

**Credit Quality Indicators**

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

commercial real estate loans. This analysis is performed on a monthly basis. The Company uses the following definitions for risk ratings:

Special Mention. A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the

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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)

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 September 30, 2017, 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	\$80,401	\$ —	\$ 257	\$ 1,653	\$82,311
One-to-four family residential real estate loans – non-owner occupied	22,258	—	40	577	22,875
Multi-family mortgage loans - Illinois	289,175	—	480	372	290,027
Multi-family mortgage loans - Other	286,398	—	—	—	286,398
Nonresidential real estate loans	176,139	—	162	—	176,301
Construction loans	2,543	—	—	—	2,543
Land loans	284	—	—	—	284
Commercial loans:					
Regional commercial banking	40,251	—	—	—	40,251
Health care	71,633	—	982	—	72,615
Direct commercial lessor	34,213	—	—	—	34,213
Commercial leases:					
Investment rated commercial leases	230,931	—	—	—	230,931
Other commercial leases	102,189	—	—	—	102,189
Consumer	1,747	—	—	—	1,747
	\$1,338,162	\$ —	\$ 1,921	\$ 2,602	\$1,342,685



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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, 2016, 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	\$93,514	\$—	\$ 629	\$ 2,486	\$96,629
One-to-four family residential real estate loans – non-owner occupied	38,179	—	41	369	38,589
Multi-family mortgage loans - Illinois	297,826	122	1,048	187	299,183
Multi-family mortgage loans - Other	243,704	—	—	—	243,704
Nonresidential real estate loans	180,047	—	1,845	260	182,152
Construction loans	946	—	—	—	946
Land loans	356	—	—	—	356
Commercial loans:					
Regional commercial banking	26,365	—	66	—	26,431
Health care	41,001	—	—	—	41,001
Direct commercial lessor	30,881	800	—	—	31,681
Commercial leases:					
Investment rated commercial leases	271,972	—	—	—	271,972
Other commercial leases	84,356	161	—	—	84,517
Consumer	2,255	—	—	—	2,255
	\$1,311,402	\$1,083	\$ 3,629	\$ 3,302	\$1,319,416

## 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.

	September 30, 2017			December 31, 2016		
	Balance	Valuation Allowance	Net OREO Balance	Balance	Valuation Allowance	Net OREO Balance
One-to-four family residential	\$11,955	\$ (207)	\$ 1,748	\$1,702	\$ (137)	\$ 1,565
Multi-family mortgage	—	—	—	370	—	370
Nonresidential real estate	1,772	(221)	1,551	1,171	(105)	1,066
Land	314	(44)	270	1,101	(207)	894
	\$4,041	\$ (472)	\$ 3,569	\$4,344	\$ (449)	\$ 3,895

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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 September 30, 2017		For the Nine Months Ended September 30, 2016	
Beginning balance	\$4,896	\$5,373	\$3,895	\$7,011
New foreclosed properties	105	94	2,041	215
Valuation adjustments	(227 )	(115 )	(301 )	(244 )
Sales and Payments	(1,205 )	(971 )	(2,066 )	(2,601 )
Ending balance	\$3,569	\$4,381	\$3,569	\$4,381

Activity in the valuation allowance is as follows:

	For the Three Months Ended September 30, 2017		For the Nine Months Ended September 30, 2016	
Beginning balance	\$308	\$664	\$449	\$1,042
Additions charged to expense	227	115	301	244
Reductions from sales of other real estate owned	(63 )	(170 )	(278 )	(677 )
Ending balance	\$472	\$609	\$472	\$609

At September 30, 2017 and December 31, 2016, the balance of OREO included no foreclosed residential real estate properties recorded as a result of obtaining physical possession of the property without title. At September 30, 2017 and December 31, 2016, the recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceeds were in process was \$1.4 million and \$1.6 million, respectively.

## 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.

	Overnight and Continuous	Up to 30 days	30 - 90 days	Greater Than 90 days	Total
September 30, 2017					
Repurchase agreements and repurchase-to-maturity transactions	\$ 928	\$ —	\$ —	\$ —	—\$928
Gross amount of recognized liabilities for repurchase agreements in Statement of Condition					\$928

## December 31, 2016

Repurchase agreements and repurchase-to-maturity transactions	\$ 1,069	\$ —	\$ —	\$ —	—\$1,069
Gross amount of recognized liabilities for repurchase agreements in Statement of Condition					\$1,069

Securities sold under agreements to repurchase were secured by mortgage-backed securities with a carrying amount of \$4.0 million and \$4.7 million at September 30, 2017 and December 31, 2016, respectively. Also included in total borrowings were advances from the FHLBC of \$60.0 million at September 30, 2017 and \$50.0 million at

December 31, 2016, respectively.

Because security values fluctuate due to market conditions, the Company has no control over the market value of securities sold under agreements to repurchase. The Company is contractually obligated to promptly transfer additional securities to the counterparty if the market value of the securities falls below the repurchase price.

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## NOTE 7 – EMPLOYEE BENEFIT PLAN

Employee Stock Ownership Plan. On March 29, 2017, the ESOP was terminated and the ESOP repaid all amounts owing under the ESOP's Term Loan Agreement with the Company (the "Share Acquisition Loan"). The ESOP repaid the Share Acquisition Loan by transferring 753,490 unallocated shares of the Company's common stock to the Company in exchange for the full satisfaction of the Share Acquisition Loan, using the valuation method provided for in the ESOP. A total of 78,362 unallocated shares remained in the ESOP after the Share Acquisition Loan was repaid, and these shares were released and will be allocated to the accounts of eligible ESOP participants who were actively employed by the Bank as of March 29, 2017, based on their account balances, subject to the receipt of a favorable IRS determination letter. These transactions resulted in the recording of one-time, non-cash, non-tax deductible equity compensation expense of \$1.1 million in the first quarter of 2017. The Share Acquisition Loan had no outstanding principal balance at September 30, 2017 and an outstanding principal balance of \$10.8 million at December 31, 2016. The Company made the Share Acquisition Loan to the ESOP in the original principal amount of \$19.6 million in connection with the Company's mutual to stock conversion in June of 2005. The proceeds of the Share Acquisition Loan were used by the ESOP to purchase 1,957,300 shares of the Company's common stock issued in the subscription offering at a price of \$10.00 per share. The Share Acquisition Loan was secured by a pledge of the acquired shares and the ESOP made annual loan payments with funds it received from the Bank's discretionary contributions to the ESOP in subsequent years and dividends it received on unallocated shares. As loan payments were made, the Company recorded compensation expense based on the allocation of shares released. ESOP benefit expense was recorded based upon the fair value of the awarded shares, net of dividends and interest received on unallocated ESOP shares. ESOP benefit expense totaled \$1.3 million for the year ended December 31, 2016.

Shares held by the ESOP were as follows:

	September 30, December 31,	
	2017	2016
Allocated to participants	1,203,810	1,125,448
Distributed to participants	(317,914)	(313,223 )
Unearned	—	831,852
Total ESOP shares	885,896	1,644,077
Fair value of unearned shares \$	—	\$ 12,328

## NOTE 8 – EQUITY INCENTIVE PLAN

On June 27, 2006, the Company's stockholders approved the BankFinancial Corporation 2006 Equity Incentive Plan, which authorized the Human Resources Committee of the Board of Directors of the Company to grant a variety of cash- and equity-based incentive awards, including stock options, stock appreciation rights, restricted stock, performance shares and other incentive awards, to employees and directors aggregating up to 3,425,275 shares of the Company's common stock. The Plan provides that no awards may be granted under the Plan after the ten-year anniversary of the Effective Date. Consequently, no further awards will be granted under this Plan.

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 8 – EQUITY INCENTIVE PLAN (continued)

As of December 31, 2016, there were 1,752,156 stock options outstanding. The Company recognized \$979,000 of equity-based compensation expense relating to the granting of stock options for the year ended December 31, 2016. There was no equity-based compensation expense for the nine months ended September 30, 2017. A summary of the activity in the stock option plan for 2017 and 2016 follows:

Stock Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value <sup>(1)</sup>
Stock options outstanding at December 31, 2015	1,752,156	\$ 12.30	1.48	\$ 778
Stock options granted	—	—		
Stock options exercised	—	—		
Stock options outstanding at December 31, 2016	1,752,156	\$ 12.30	0.48	\$ 4,422
Stock options granted	—	—		
Stock options exercised	(1,752,156)	12.30		
Stock options outstanding at September 30, 2017	—	\$ —	0	\$ —

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

During the nine months ended September 30, 2017, 1,752,156 stock options were exercised. All stock options were exercised on a net settlement basis, using a portion of the shares obtained upon exercise to pay the exercise price of the stock option. The net settlements resulted in the issuance of 280,554 shares of the Company's common stock. Certain employees also chose to use a portion of the net shares received upon the exercise to pay required tax withholdings. This reduced the net shares issued by 82,528 shares to 198,026 shares.

## NOTE 9 – FAIR VALUE

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

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

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

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

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

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

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available for similar loans and collateral underlying such

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 9 - FAIR VALUE (continued)

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.

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

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)			Fair Value
	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
September 30, 2017				
Securities:				
Certificates of deposit	\$—	\$ 80,360	\$	—\$80,360
Equity mutual fund	502	—	—	502
Mortgage-backed securities – residential	—	13,188	—	13,188
Collateralized mortgage obligations – residential	—	4,725	—	4,725
SBA-guaranteed loan participation certificates	—	12	—	12
	\$502	\$ 98,285	\$	—\$98,787
December 31, 2016				
Securities:				
Certificates of deposit	\$—	\$ 85,938	\$	—\$85,938
Equity mutual fund	499	—	—	499
Mortgage-backed securities - residential	—	15,184	—	15,184
Collateralized mortgage obligations – residential	—	5,574	—	5,574
SBA-guaranteed loan participation certificates	—	17	—	17
	\$499	\$ 106,713	\$	—\$107,212





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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 9 - 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		
	Markets		
	for		
	Identical		
	Assets		
	(Level 1)		
	Significant		
	Observable		
	Inputs		
	(Level 2)		
	Significant		
	Unobservable		
	Inputs		
	(Level 3)		
	Fair		
	Value		
September 30, 2017			
Other real estate owned:			
One-to-four family residential real estate	\$—	—\$ 1,421	\$1,421
Nonresidential real estate	—	844	844
	\$—	—\$ 2,265	\$2,265
December 31, 2016			
Impaired loans:			
Nonresidential real estate	—	234	234
	\$—	—\$ 234	\$234
Other real estate owned:			
One-to-four family residential real estate	\$—	—\$ 1,282	\$1,282
Nonresidential real estate	—	553	553
Land	—	47	47
	\$—	—\$ 1,882	\$1,882

At September 30, 2017 there were no impaired loans that were measured for impairment using the fair value of the collateral for collateral-dependent loans and which had specific valuation allowances, compared to one impaired loan with a carrying amount of \$260,000 and having specific valuation allowance of \$26,000 at December 31, 2016. The decrease in the valuation allowance resulted in a decrease in the provision for loan losses of \$26,000 for the nine months ended September 30, 2017. There was a decrease in the provision for loan losses of \$5,000 for the nine months ended September 30, 2016.

OREO, which is carried at the lower of cost or fair value less costs to sell, had a carrying value of \$2.7 million less a valuation allowance of \$429,000, or \$2.3 million, at September 30, 2017, compared to a carrying value of \$2.3 million less a valuation allowance of \$434,000, or \$1.9 million, at December 31, 2016. There were \$301,000 of valuation adjustments of OREO recorded for the nine months ended September 30, 2017. There were \$244,000 of valuation adjustments of OREO recorded for the nine months ended September 30, 2016.

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 9 - FAIR VALUE (continued)

The following table presents quantitative information, based on certain empirical data with respect to Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at September 30, 2017:

	Fair Value	Valuation Technique(s)	Significant Unobservable Input(s)	Range (Weighted Average)
Other real estate owned:				
One-to-four family residential real estate	\$ 1,421	Sales comparison	Discount applied to valuation	5.6% - 6.6% (6.5%)
Nonresidential real estate loans	\$ 844	Sales comparison	Comparison between sales and income approaches	-3.66% - 15.22% (10.9%)
Other real estate owned	\$ 2,265			

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, 2016:

	Fair Value	Valuation Technique(s)	Significant Unobservable Input(s)	Range (Weighted Average)
Impaired loans				
Nonresidential real estate	\$ 234	Sales comparison	Comparison between sales and income approaches	-10.2%
		Income approach	Cap Rate	8.5%
	\$ 234			
Other real estate owned				
One-to-four family residential real estate	\$ 1,282	Sales comparison	Discount applied to valuation	8.62% to 20.04% (11.9%)
Nonresidential real estate	553	Sales comparison	Comparison between sales and income approaches	-3.22% to 4.58% (3.7%)
Land	47	Sales comparison	Discount applied to valuation	5.74% to 31.60% (25.2%)
	\$ 1,882			

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 9 - FAIR VALUE (continued)

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

Fair Value Measurements at September 30, 2017 Using:					
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	\$125,661	\$10,620	\$115,041	\$	—\$125,661
Securities	98,787	502	98,285	—	98,787
Loans receivable, net of allowance for loan losses	1,335,631	—	1,340,957	—	1,340,957
FHLBC and FRB stock	8,290	—	—	—	N/A
Accrued interest receivable	4,569	—	4,569	—	4,569
Financial liabilities					
Noninterest-bearing demand deposits	\$231,049	\$—	\$231,049	\$	—\$231,049
Savings deposits	158,696	—	158,696	—	158,696
NOW and money market accounts	585,316	—	585,316	—	585,316
Certificates of deposit	396,028	—	394,888	—	394,888
Borrowings	60,928	—	60,932	—	60,932
Accrued interest payable	180	—	180	—	180

Fair Value Measurements at December 31, 2016 Using:					
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	\$96,684	\$13,053	\$83,631	\$	—\$96,684
Securities	107,212	499	106,713	—	107,212
Loans receivable, net of allowance for loan losses	1,312,952	—	1,322,713	234	1,322,947
FHLBC and FRB stock	11,650	—	—	—	N/A
Accrued interest receivable	4,381	—	4,381	—	4,381
Financial liabilities					
Noninterest-bearing demand deposits	\$249,539	\$—	\$249,539	\$	—\$249,539
Savings deposits	160,002	—	160,002	—	160,002
NOW and money market accounts	578,237	—	578,237	—	578,237
Certificates of deposit	351,612	—	350,593	—	350,593
Borrowings	51,069	—	50,015	—	50,015
Accrued interest payable	102	—	102	—	102

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.

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 9 - FAIR VALUE (continued)

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

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

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

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

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

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

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

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

Cautionary Statement Regarding Forward-Looking Information

Forward Looking Statements

This Quarterly Report on Form 10-Q contains, and other periodic and current reports, press releases and other public stockholder communications of BankFinancial Corporation may contain, forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, that involve significant risks and uncertainties. Forward-looking statements may include statements relating to our future plans, strategies and expectations, as well as our future revenues, earnings, losses, financial performance, financial condition, asset quality metrics and future prospects. Forward looking statements are generally identifiable by use of the words "believe," "may," "will," "should," "could," "expect," "estimate," "intend," "anticipate," "preliminary," "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, in the Chicago metropolitan area in particular and in other market areas where we

operate 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, 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,

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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 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, together with the Risk Factors and other information set forth in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016 and this Quarterly Report on Form 10-Q, as well as other filings we make with the SEC, 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, 2016, and all amendments thereto, as filed with the SEC.

### Overview

Total loans remained stable in the third quarter of 2017 as strong originations in commercial and industrial loans and multi-family real estate loans were offset by higher than expected payoffs in commercial leases and investor one-to-four family residential loans. Total commercial and industrial loans increased by 14% on a linked-quarter basis consistent with our recent conversion to a national bank charter. We expect continued growth in commercial and industrial loan originations and multi-family lending consistent with previous quarters and a resumption of growth in commercial lease originations in the last quarter of 2017.

We recorded a decrease to our provision for loan losses in the third quarter of 2017, as recoveries on previously-charged off loans exceeded the additional loan loss provision required due to growth in commercial-related loan balances. Based on the current loan portfolio composition and activity, we expect net interest margin to trend towards 3.30% during the fourth quarter of 2017, without regard to any further Federal Reserve rate increases.

Non-interest income increased modestly due primarily to higher deposit-account related fee income, loan fee income and other income. Additional growth in commercial and industrial lending, together with new product development within commercial leasing, multi-family/commercial real estate and trust operations, may contribute to further increases in non-interest income in future quarters.

Non-interest expense increased due to increased incentive compensation related to loan originations, and increased occupancy expenses primarily related to real estate tax expenses. The growth within multi-family lending, healthcare lending and direct commercial lessor finance required us to file additional state franchise tax returns; however, we expect to gain the benefit of lower state income tax rates from certain new markets in future periods. We also recognized additional advance disposition costs as we further accelerated the reduction of our remaining Other Real Estate Owned balances during the third quarter of 2017, with a goal to reduce the balance at December 31, 2017 by 40% or more of the September 30, 2017 balance. Other non-interest expenses remained well-contained.

Our ratio of nonperforming loans to total loans was 0.19%, for commercial related loans the ratio was 0.03%, and our ratio of non-performing assets to total assets was 0.37% at September 30, 2017. Our classified assets-to-Tier 1

Capital+ALLL ratio was 4.40%. We expect continued reductions of the OREO balance and scheduled pending resolutions will further improve our asset quality.



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## SELECTED FINANCIAL DATA

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

	September 30, 2017	December 31, 2016	Change			
	(Dollars in thousands)					
Selected Financial Condition Data:						
Total assets	\$ 1,654,269	\$ 1,620,037	\$ 34,232			
Loans, net	1,335,631	1,312,952	22,679			
Securities, at fair value	98,787	107,212	(8,425 )			
Other real estate owned, net	3,569	3,895	(326 )			
Deposits	1,371,089	1,339,390	31,699			
Borrowings	60,928	51,069	9,859			
Equity	199,778	204,780	(5,002 )			

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	Three Months Ended September 30, 2017		2016		Nine Months Ended September 30, 2017		2016	
Selected Financial Ratios and Other Data:								
Performance Ratios:								
Return on assets (ratio of net income to average total assets) <sup>(1)</sup>	0.88	%	0.66	%	0.66	%	0.46	%
Return on equity (ratio of net income to average equity) <sup>(1)</sup>	7.07		4.86		5.26		3.34	
Average equity to average assets	12.40		13.64		12.61		13.84	
Net interest rate spread <sup>(1) (2)</sup>	3.10		3.23		3.12		3.25	
Net interest margin <sup>(1) (3)</sup>	3.23		3.33		3.24		3.34	
Efficiency ratio <sup>(4)</sup>	72.19		73.60		74.77		78.11	
Noninterest expense to average total assets <sup>(1)</sup>	2.51		2.62		2.57		2.76	
Average interest-earning assets to average interest-bearing liabilities	131.23		134.36		131.69		135.58	
Dividends declared per share	\$0.07		\$0.05		\$0.20		\$0.15	
Dividend payout ratio	35.69	%	38.82	%	46.30	%	56.79	%
	At September 30, 2017		At December 31, 2016					
Asset Quality Ratios:								
Nonperforming assets to total assets <sup>(5)</sup>	0.37	%	0.44	%				
Nonperforming loans to total loans	0.19		0.25					
Allowance for loan losses to nonperforming loans	321.46		246.57					
Allowance for loan losses to total loans	0.62		0.62					
Capital Ratios:								
Equity to total assets at end of period	12.08	%	12.64	%				
Tier 1 leverage ratio (Bank only)	10.94	%	10.27	%				
Other Data:								
Number of full-service offices	19		19					
Employees (full-time equivalents)	238		246					

(1) Ratios annualized.

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

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

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

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

## Comparison of Financial Condition at September 30, 2017 and December 31, 2016

Total assets increased \$34.2 million, or 2.1%, to \$1.654 billion at September 30, 2017, from \$1.620 billion at December 31, 2016. The increase in total assets was primarily due to increases in cash and cash equivalents and loans. Cash and cash equivalents increased \$29.0 million, or 30.0%, to \$125.7 million at September 30, 2017, from \$96.7 million at December 31, 2016. Loans increased \$22.7 million, or 1.7%, to \$1.336 billion at September 30, 2017, from \$1.313 billion at December 31, 2016. Partially offsetting the increases in cash and cash equivalents and loans was a decrease in securities of \$8.4 million, or 7.9%, to \$98.8 million at September 30, 2017, from \$107.2 million at December 31, 2016.

Our loan portfolio consists primarily of investment and business loans (multi-family, nonresidential real estate, commercial, construction and land loans, and commercial leases), which together totaled 92.0% of gross loans at

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September 30, 2017. Commercial loans increased by \$44.0 million, or 42.7% and multi-family mortgage loans increased by \$33.5 million, or 6.2%, during the nine months ended September 30, 2017. Commercial leases decreased \$19.4 million, or 5.5%. Our 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

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selected metropolitan areas outside our primary lending area, and engage in certain types of commercial lending and leasing activities on a nationwide basis. At September 30, 2017, \$281.4 million, or 48.8%, of our multi-family loans were in the Metropolitan Statistical Area for Chicago, Illinois; \$73.4 million, or 12.7%, were in the Metropolitan Statistical Area for Dallas, Texas; \$52.6 million, or 9.1%, were in the Metropolitan Statistical Area for Denver, Colorado; \$29.6 million, or 5.1%, were in the Metropolitan Statistical Area for Tampa, Florida and \$17.9 million, or 3.1%, were in the Metropolitan Statistical Area for Minneapolis, Minnesota. This information reflects the location of the collateral, but does not necessarily reflect the location of the borrower.

Total liabilities increased \$39.2 million, or 2.8%, to \$1.454 billion at September 30, 2017, from \$1.415 billion at December 31, 2016, primarily due to increases in interest-bearing NOW accounts and certificates of deposit. The increases were partially offset by decreases in noninterest-bearing accounts and money market accounts. Total deposits increased \$31.7 million, or 2.4%, to \$1.371 billion at September 30, 2017, from \$1.339 billion at December 31, 2016. Certificates of deposit increased \$44.4 million, or 12.6%, to \$396.0 million at September 30, 2017, from \$351.6 million at December 31, 2016. Interest-bearing NOW accounts increased \$16.4 million, or 6.1%, to \$283.4 million at September 30, 2017, from \$267.1 million at December 31, 2016. Savings accounts decreased \$1.3 million, or 0.8%, to \$158.7 million at September 30, 2017, from \$160.0 million at December 31, 2016.

Noninterest-bearing demand deposits decreased \$18.5 million, or 7.4%, to \$231.0 million at September 30, 2017, from \$249.5 million at December 31, 2016. Money market accounts decreased \$9.3 million, or 3.0%, to \$301.9 million at September 30, 2017, from \$311.2 million at December 31, 2016. Core deposits (which consists of savings, money market, noninterest-bearing demand and NOW accounts) were 71.1% and 73.7% of total deposits at September 30, 2017 and December 31, 2016, respectively.

Total stockholders' equity was \$199.8 million at September 30, 2017, compared to \$204.8 million at December 31, 2016. The decrease in total stockholders' equity during the nine months ended September 30, 2017 was due to the combined impact of our repurchase of 614,673 shares of our common stock at a total cost of \$9.1 million, our declaration and payment of cash dividends totaling \$3.7 million, and the \$1.2 million net impact of stock option exercises. These items were partially offset by the net income of \$8.0 million that we recorded for the nine months ended September 30, 2017 and the \$1.1 million impact of the ESOP loan repayment that was made on March 29, 2017.

#### Operating Results for the Three Months Ended September 30, 2017 and 2016

**Net Income.** We had net income of \$3.6 million for the three months ended September 30, 2017, compared to \$2.5 million for the three months ended September 30, 2016. Earnings per basic and fully diluted share of common stock was \$0.20 for the three months ended September 30, 2017, compared to \$0.13 for the three months ended September 30, 2016.

**Net Interest Income.** Net interest income was \$12.5 million for the three months ended September 30, 2017, compared to \$11.8 million for the same period in 2016. The increase in net interest income reflected a \$1.3 million, or 9.9%, increase in interest income, which was partially offset by a \$601,000, or 59.3%, increase in interest expense.

The increase in interest income was primarily attributable to an increase in the average balance of interest-earning assets. Total average interest-earning assets increased \$121.1 million, or 8.6%, to \$1.536 billion for the three months ended September 30, 2017, from \$1.415 billion for the same period in 2016. Our net interest rate spread decreased by 13 basis points to 3.10% for the three months ended September 30, 2017, from 3.23% for the same period in 2016. Our net interest margin decreased by ten basis points to 3.23% for the three months ended September 30, 2017, from 3.33% for the same period in 2016. However, the average yield on commercial loans and leases originated in the third quarter of 2017 was 4.46%, compared to 3.73% for commercial loans and leases originated in the third quarter of 2016. The yield on interest-earning assets increased four basis points to 3.65% for the three months ended September 30, 2017, from 3.61% for the same period in 2016, and the cost of interest-bearing liabilities increased 17 basis points to 0.55% for the three months ended September 30, 2017, from 0.38% for the same period in 2016.



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## Average Balance Sheets

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

	For the Three Months Ended September 30,							
	2017		2016					
	Average		Average					
	Outstanding	Interest	Yield/Rate	(1)	Outstanding	Interest	Yield/Rate	(1)
	Balance				Balance			
	(Dollars in thousands)							
Interest-earning assets:								
Loans	\$ 1,331,302	\$ 13,345	3.98	%	\$ 1,225,480	\$ 12,388	4.02	%
Securities	108,050	389	1.43		106,904	306	1.14	
Stock in FHLBC and FRB	8,290	101	4.83		6,257	10	0.64	
Other	88,201	286	1.29		76,095	141	0.74	
Total interest-earning assets	1,535,843	14,121	3.65		1,414,736	12,845	3.61	
Noninterest-earning assets	88,594				96,739			
Total assets	\$ 1,624,437				\$ 1,511,475			
Interest-bearing liabilities:								
Savings deposits	\$ 159,464	48	0.12		\$ 157,036	43	0.11	
Money market accounts	304,553	307	0.40		313,270	243	0.31	
NOW accounts	278,389	139	0.20		257,553	95	0.15	
Certificates of deposit	369,804	925	0.99		323,076	631	0.78	
Total deposits	1,112,210	1,419	0.51		1,050,935	1,012	0.38	
Borrowings	58,112	196	1.34		1,981	2	0.40	
Total interest-bearing liabilities	1,170,322	1,615	0.55		1,052,916	1,014	0.38	
Noninterest-bearing deposits	232,464				233,914			
Noninterest-bearing liabilities	20,231				18,408			
Total liabilities	1,423,017				1,305,238			
Equity	201,420				206,237			
Total liabilities and equity	\$ 1,624,437				\$ 1,511,475			
Net interest income		\$ 12,506				\$ 11,831		
Net interest rate spread <sup>(2)</sup>			3.10	%			3.23	%
Net interest-earning assets <sup>(3)</sup>	\$ 365,521				\$ 361,820			
Net interest margin <sup>(4)</sup>			3.23	%			3.33	%
Ratio of interest-earning assets to interest-bearing liabilities	131.23	%			134.36	%		

(1) Annualized.

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

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

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



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## Provision for 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.

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.

We recorded a recovery of loan losses of \$225,000 for the three months ended September 30, 2017, compared to \$525,000 for the same period in 2016. 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 increased \$252,000, or 3.1%, to \$8.4 million at September 30, 2017, from \$8.1 million at June 30, 2017. There was no reserve established for loans individually evaluated for impairment for the three months ended September 30, 2017 or for the three months ended June 30, 2017. Net recoveries were \$477,000 for the three months ended September 30, 2017.

The allowance for loan losses as a percentage of nonperforming loans was 321.46% at September 30, 2017, compared to 274.76% at June 30, 2017.

## Noninterest Income

	Three Months Ended September 30, 2017    2016    Change		
	(Dollars in thousands)		
Deposit service charges and fees	\$584	\$583	\$ 1
Other fee income	523	478	45
Insurance commissions and annuities income	41	53	(12 )
Gain on sale of loans, net	10	38	(28 )
Loan servicing fees	58	66	(8 )
Amortization of servicing assets	(27 )	(28 )	1
Earnings on bank owned life insurance	67	54	13
Trust income	169	167	2
Other	198	226	(28 )
Total noninterest income	\$1,623	\$1,637	\$ (14 )

Noninterest income was \$1.6 million for each of the three month periods ended September 30, 2017 and 2016.

Deposit service charges and fees also remained stable at \$584,000 for the three months ended September 30, 2017, compared to \$583,000 for the three months ended September 30, 2016. Other fee income increased \$45,000, or 9.4%, to \$523,000 for the three months ended September 30, 2017, from \$478,000 for the three months ended September 30, 2016, primarily due to increased debit card fees and other loan fees. Noninterest income for the three months ended



September 30, 2017 included a \$10,000 gain on sale of loans. Earnings on bank owned life insurance increased \$13,000, or 24.1%, and trust income increased \$2,000, or 1.2%, for the three months ended September 30, 2017. Other income decreased \$28,000, or 12.4%, to \$198,000 for the three months ended September 30, 2017, compared to \$226,000 for the three months ended September 30, 2016.

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## Noninterest Expense

	Three Months Ended September 30, 2017      2016      Change		
	(Dollars in thousands)		
Compensation and benefits	\$5,330	\$5,315	\$ 15
Office occupancy and equipment	1,693	1,487	206
Advertising and public relations	167	144	23
Information technology	638	707	(69 )
Supplies, telephone and postage	337	345	(8 )
Amortization of intangibles	123	129	(6 )
Nonperforming asset management	84	89	(5 )
Loss (gain) on sale other real estate owned	69	(15 )	84
Valuation adjustments of other real estate owned	227	115	112
Operations of other real estate owned	107	143	(36 )
FDIC insurance premiums	150	238	(88 )
Other	1,275	1,215	60
Total noninterest expense	\$10,200	\$9,912	\$ 288

Noninterest expense increased by \$288,000, or 2.9%, to \$10.2 million for the three months ended September 30, 2017, from \$9.9 million for the same period in 2016. Compensation and benefits expense increased \$15,000, primarily due to increased accruals for loan origination and business plan performance incentives. Office occupancy and equipment increased \$206,000, or 13.9%, to \$1.7 million for the three months ended September 30, 2017, from \$1.5 million for the same period in 2016, primarily due to an increase in real estate taxes of \$115,000. Advertising and public relations expense increased \$23,000, or 16.0%, to \$167,000 for the three months ended September 30, 2017, from \$144,000 for the same period in 2016. Information technology expense decreased \$69,000, or 9.8%, to \$638,000 for the three months ended September 30, 2017, from \$707,000 for the same period in 2016. Nonperforming asset management expense decreased \$5,000, or 5.6%, to \$84,000 for the three months ended September 30, 2017, from \$89,000 for the same period in 2016, primarily due to a \$39,000 reduction in legal expenses. Valuation adjustments for OREO totaled \$227,000 for the three months ended September 30, 2017, compared to \$115,000 for the same period in 2016, due to initiatives that we undertook to accelerate OREO dispositions. Other expenses increased \$60,000, or 4.9%, to \$1.3 million for the three months ended September 30, 2017, from \$1.2 million for the same period in 2016, primarily due to increased state tax audit and planning and state franchise tax payments.

## Income Taxes

For the three months ended September 30, 2017, we recorded income tax expense of \$594,000, compared to \$1.6 million for the three months ended September 30, 2016. Our income tax expense was reduced by \$879,000 for the quarter due to an increase in the deferred tax asset related to our Illinois net operating loss carryforward. Effective in July 2017, our Illinois income tax rate increased from 7.75% to 9.5%. Our effective tax rate for the three months ended September 30, 2017 was 14.3%, compared to 38.5% for the same period in 2016.

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Operating Results for the Nine Months Ended September 30, 2017 and 2016

Net Income. We had net income of \$8.0 million for the nine months ended September 30, 2017, compared to \$5.2 million for the nine months ended September 30, 2016. The increase in net income reflects an increase in interest income of \$2.9 million in 2017 and the fact that our 2016 operating results were adversely impacted by 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. Our earnings per basic and fully diluted share of common stock were \$0.44 for the nine months ended September 30, 2017, compared to \$0.27 per basic and fully diluted share for the same period in 2016.

Net Interest Income. Net interest income was \$36.8 million for the nine months ended September 30, 2017, compared to \$35.4 million for the same period in 2016. The increase in net interest income reflected a \$2.9 million increase in interest income, which was partially offset by a \$1.5 million increase in interest expense.

The increase in net interest income was primarily attributable to an increase in the average balance of interest-earning assets, which increased \$105.3 million, or 7.4%, to \$1.519 billion for the nine months ended September 30, 2017, from \$1.414 billion for the same period in 2016. Our net interest rate spread decreased by 13 basis points to 3.12% for the nine months ended September 30, 2017, compared to 3.25% for the same period in 2016. Our net interest margin decreased by ten basis point to 3.24% for the nine months ended September 30, 2017, compared to 3.34% for the same period in 2016. However the average yield on commercial loans and leases originated in the nine months of 2017 was 4.34%, compared to 3.69% for commercial loans and leases originated in the nine months of 2016. The yield on interest-earning assets increased one basis points to 3.62% for the nine months ended September 30, 2017, from 3.61% for the same period in 2016, and the cost of interest-bearing liabilities increased 14 basis points to 0.50% for the nine months ended September 30, 2017, from 0.36% for the same period in 2016.

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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 Nine Months Ended September 30,						
	2017				2016		
	Average				Average		
	Outstanding	Interest	Yield/Rate	(1)	Outstanding	Interest	Yield/Rate (1)
	Balance				Balance		
	(Dollars in thousands)						
Interest-earning assets:							
Loans	\$ 1,321,051	\$ 39,061	3.95	%	\$ 1,224,779	\$ 36,834	4.02 %
Securities	110,399	1,095	1.33		111,399	927	1.11
Stock in FHLBC and FRB	8,563	301	4.70		6,257	53	1.13
Other	79,258	675	1.14		71,516	371	0.69
Total interest-earning assets	1,519,271	41,132	3.62		1,413,951	38,185	3.61
Noninterest-earning assets	91,438				97,803		
Total assets	\$ 1,610,709				\$ 1,511,754		
Interest-bearing liabilities:							
Savings deposits	\$ 160,460	138	0.11		\$ 158,671	128	0.11
Money market accounts	305,776	886	0.39		319,299	738	0.31
NOW accounts	272,149	395	0.19		251,423	278	0.15
Certificates of deposit	362,346	2,484	0.92		287,074	1,605	0.75
Total deposits	1,100,731	3,903	0.47		1,016,467	2,749	0.36
Borrowings	52,898	444	1.12		26,398	73	0.37
Total interest-bearing liabilities	1,153,629	4,347	0.50		1,042,865	2,822	0.36
Noninterest-bearing deposits	232,662				238,827		
Noninterest-bearing liabilities	21,379				20,822		
Total liabilities	1,407,670				1,302,514		
Equity	203,039				209,240		
Total liabilities and equity	\$ 1,610,709				\$ 1,511,754		
Net interest income		\$ 36,785				\$ 35,363	
Net interest rate spread (2)			3.12	%			3.25 %
Net interest-earning assets (3)	\$ 365,642				\$ 371,086		
Net interest margin (4)			3.24	%			3.34 %
Ratio of interest-earning assets to interest-bearing liabilities	131.69	%			135.58	%	

(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 recorded a recovery of loan losses of \$15,000 for the nine months ended September 30, 2017, compared to a provision of \$300,000 for the same period in 2016. The portion of the allowance for loan losses attributable to loans collectively evaluated for impairment increased \$273,000, or 3.4%, to \$8.4 million at September 30, 2017. The reserve established for loans individually evaluated for impairment decreased \$26,000 to zero at September 30, 2017. Net recoveries were \$262,000 for the nine months ended September 30, 2017, compared to net charge-offs of \$1.7 million for the same period in 2016. Net charge-offs in 2016 included a \$1.6 million charge-off resulting from the sale of three performing loans to a single borrower with a total carrying value of \$16.2 million in the second quarter of 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 pursue 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 321.46% at September 30, 2017, compared to 246.57% at December 31, 2016.

## Noninterest Income

	Nine Months Ended September 30, 2017    2016    Change		
	(Dollars in thousands)		
Deposit service charges and fees	\$1,682	\$1,691	\$ (9 )
Other fee income	1,494	1,478	16
Insurance commissions and annuities income	170	180	(10 )
Gain on sale of loans, net	70	59	11
Gain on sales of securities	—	46	(46 )
Loan servicing fees	188	214	(26 )
Amortization of servicing assets	(86 )	(96 )	10
Earnings on bank owned life insurance	196	151	45
Trust income	534	492	42
Other	526	553	(27 )
Total noninterest income	\$4,774	\$4,768	\$ 6

Noninterest income remained constant at \$4.8 million for the nine month periods ended September 30, 2017 and 2016. Other fee income increased \$16,000, or 1.1%. Noninterest income for the nine months ended September 30, 2017 included a \$70,000 gain on sale of loans, compared to a \$59,000 gain on sale of loans for the same period in 2016. Loan servicing fees decreased \$26,000 compared to the same nine month period in 2016 due to a decrease in the balance of loans serviced for others.

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## Noninterest Expense

	Nine Months Ended September 30,		
	2017	2016	Change
	(Dollars in thousands)		
Compensation and benefits	\$16,792	\$17,021	\$(229 )
Office occupancy and equipment	4,914	4,769	145
Advertising and public relations	807	618	189
Information technology	2,070	2,130	(60 )
Supplies, telephone and postage	1,027	1,018	9
Amortization of intangibles	374	394	(20 )
Nonperforming asset management	215	300	(85 )
Loss (gain) on sale other real estate owned	100	(15 )	115
Valuation adjustments of other real estate owned	301	244	57
Operations of other real estate owned	460	539	(79 )
FDIC insurance premiums	462	691	(229 )
Other	3,551	3,639	(88 )
Total noninterest expense	\$31,073	\$31,348	\$(275 )

Noninterest expense decreased by \$275,000, or 0.9%, to \$31.1 million for the nine months ended September 30, 2017, from \$31.3 million for the same period in 2016. Compensation and benefits expense decreased \$229,000, or 1.3%, due in substantial part to a decrease of \$590,000 in stock-based compensation expense for the nine months ended September 30, 2017, which was partially offset by increased accruals for loan origination and business plan performance incentives. In the first quarter of 2017, we recorded a one-time, non-cash, non-tax deductible equity compensation expense of \$1.1 million related to the termination of the Bank's ESOP and the repayment of the ESOP's Share Acquisition Loan. ESOP and equity-based compensation expense for the nine months ended September 30, 2016 was \$1.7 million. Expenses for office occupancy and equipment increased \$145,000, or 3.0%, primarily due to increased real estate taxes and increased rent expense for the lending operations in selected metropolitan areas outside our primary lending area. Operations of OREO decreased \$79,000, or 14.7%, due to decreases in legal expense and maintenance and repairs expense, partially offset by a decrease of \$80,000 in rental income. Other expenses decreased \$88,000, or 2.4%, primarily due to reductions in loss due to fraud in the nine months ended September 30, 2017 and the fact that we recorded an expense of \$150,000 in the nine months ended September 30, 2016 for a mortgage representation and warranty reserve for mortgage loans sold and serviced for others.

## Income Taxes

For the nine months ended September 30, 2017, we recorded \$2.5 million of income tax expense, compared to \$3.2 million for the nine months ended September 30, 2016. Our effective tax rate for the nine months ended September 30, 2017 was 23.7%, compared to 38.2% for the same period in 2016. Our effective tax rate for the nine months ended September 30, 2017 included the impact of the stock option exercises and the one-time, non-cash, non-tax deductible equity compensation expense relating to the termination of the ESOP. In addition, our income tax expense was reduced by \$879,000 due to an increase in the deferred tax asset related to our Illinois net operating loss carryforward. Effective in July 2017, our Illinois income tax rate increased from 7.75% to 9.5%.

## Nonperforming Loans and Assets

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

have loans classified as 90 days or more delinquent and still accruing. Generally, we do not utilize this category of loan classification unless: (1) the loan is repaid in full shortly after the period end date; (2) the loan is well secured and there are no asserted or pending legal barriers to its collection; or (3) the borrower has remitted all scheduled payments and is otherwise in substantial compliance with the terms of the loan, but the processing of loan payments actually



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received or the renewal of the loan has not occurred for administrative reasons. At September 30, 2017, we had no loans in this category.

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

As part of the asset classification process, we develop an exit strategy for real estate collateral or OREO by assessing overall market conditions, the current use and condition of the asset, and its highest and best use. For most income-producing real estate, we believe that investors value most highly a stable income stream from the asset; consequently, we perform a comparative evaluation to determine whether conducting a sale on an “as-is”, “as-stabilized” or “as-completed” basis is most likely to produce the highest net realizable value. If we determine that the “as-stabilized” or “as-completed” basis is appropriate, we then complete the necessary improvements or tenant stabilization tasks, with the applicable time value discount and improvement expenses incorporated into our estimates of the expected costs to sell. As of September 30, 2017, substantially all impaired real estate loan collateral and OREO were valued on an “as-is basis.”

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

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## Nonperforming Assets Summary

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

	September 30, 2017	June 30, 2017	December 31, 2016	Quarter Change	Nine Month Change
(Dollars in thousands)					
Nonaccrual loans:					
One-to-four family residential real estate	\$2,234	\$2,585	\$ 2,851	\$(351 )	\$(617 )
Multi-family mortgage	371	371	185	—	186
Nonresidential real estate	—	—	260	—	(260 )
	2,605	2,956	3,296	(351 )	(691 )
Other real estate owned:					
One-to-four family residential	1,748	1,946	1,565	(198 )	183
Multi-family mortgage	—	357	370	(357 )	(370 )
Nonresidential real estate	1,551	1,736	1,066	(185 )	485
Land	270	857	894	(587 )	(624 )
	3,569	4,896	3,895	(1,327 )	(326 )
Total nonperforming assets	\$6,174	\$7,852	\$ 7,191	\$(1,678)	\$(1,017)
Ratios:					
Nonperforming loans to total loans	0.19	% 0.22	% 0.25	%	
Nonperforming assets to total assets	0.37	0.48	0.44		

## Nonperforming Assets

Nonperforming assets totaled \$6.2 million, \$7.9 million, and \$7.2 million at September 30, 2017, June 30, 2017 and December 31, 2016, respectively. Nonperforming assets decreased \$1.7 million, during the three months ended September 30, 2017. Although we experience occasional isolated instances of new nonaccrual loans, we believe that continuing our aggressive resolution posture will maintain the trends favoring very strong asset quality.

Five residential, one multi-family loan and two nonresidential real estate loans with an aggregate book balance of \$2.0 million were transferred from nonaccrual loans to OREO during the nine months ended September 30, 2017. We continue to experience modest quantities of defaults on residential real estate loans principally due either to the borrower's personal financial condition or deteriorated collateral value.

## Liquidity and Capital Resources

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

Our primary sources of funds are deposits, principal and interest payments on loans and securities, and, to a lesser extent, wholesale borrowings, the proceeds from maturing securities and short-term investments, and the proceeds from the sales of loans and securities and lease payments. The scheduled amortization of loans and securities, as well as proceeds from borrowings, are predictable sources of funds. Other funding sources, however, such as deposit inflows, mortgage prepayments and mortgage loan sales are greatly influenced by market interest rates, economic conditions and competition. We anticipate that we will have sufficient funds available to meet current loan commitments and lines of credit and maturing certificates of deposit that are not renewed or extended. We generally remain fully invested and utilize FHLBC advances as an additional sources of funds. We had \$60.0 million of FHLBC advances at September 30, 2017 and \$50.0 million at December 31, 2016.

As of September 30, 2017, we were not aware of any known trends, events or uncertainties that had or were reasonably likely to have a material impact on our liquidity. As of September 30, 2017, we had no other material commitments for capital expenditures.



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

The Bank and the Company are subject to regulatory capital requirements administered by the federal banking agencies. The capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve the quantitative measurement of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. The failure to meet minimum capital requirements can result in regulatory actions. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital.

Prompt corrective action regulations provide five classifications: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If only adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. As of September 30, 2017 and December 31, 2016, the OCC categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since those notifications that management believes have changed the institution's well-capitalized status.

The Company and the Bank have each adopted Regulatory Capital Plans that require the Bank to maintain a Tier 1 leverage ratio of at least 7.5%, 7.0% for common equity tier 1 capital and a total risk-based capital ratio of at least 10.5% (including the Capital Conservation Buffer ("CCB")). The minimum capital ratios set forth in the Regulatory Capital Plans will be increased or decreased and other minimum capital requirements will be established if and as necessary. In accordance with the Regulatory Capital Plans, neither the Company nor the Bank will pursue any acquisition or growth opportunity, declare any dividend or conduct any stock repurchase that would cause the Bank's total risk-based capital ratio and/or its Tier 1 leverage ratio to fall below the established minimum capital levels or the capital levels required for capital adequacy plus the CCB. The minimum CCB at September 30, 2017 is 1.25% and will increase 0.625% annually through 2019 to 2.5%. In addition, the Company will continue to maintain its ability to serve as a source of financial strength to the Bank by holding at least \$5.0 million of cash or liquid assets for that purpose. As of September 30, 2017, the Bank and the Company were well-capitalized, with all capital ratios exceeding the well-capitalized requirement. There are no conditions or events that management believes have changed the Bank's prompt corrective action capitalization category.

The Bank is subject to regulatory restrictions on the amount of dividends it may declare and pay to the Company without prior regulatory approval, and to regulatory notification requirements for dividends that do not require prior regulatory approval.

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Actual and required capital amounts and ratios were:

	Actual		Required for Capital Adequacy Purposes		To be Well-Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
September 30, 2017						
Total capital (to risk-weighted assets):						
Consolidated	\$191,058	16.43 %	\$93,011	8.00%	N/A	N/A
BankFinancial, NA	184,213	15.85	92,998	8.00	\$116,247	10.00 %
Tier 1 (core) capital (to risk-weighted assets):						
Consolidated	182,683	15.71	69,758	6.00	N/A	N/A
BankFinancial, NA	175,838	15.13	69,748	6.00	92,998	8.00
Common Tier 1 (CET1)						
Consolidated	182,683	15.71	52,319	4.50	N/A	N/A
BankFinancial, NA	175,838	15.13	52,311	4.50	75,561	6.50
Tier 1 (core) capital (to adjusted average total assets):						
Consolidated	182,683	11.36	64,310	4.00	N/A	N/A
BankFinancial, NA	175,838	10.94	64,306	4.00	80,382	5.00
	Actual		Required for Capital Adequacy Purposes		To be Well-Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
December 31, 2016						
Total capital (to risk-weighted assets):						
Consolidated	\$193,845	16.96 %	\$91,414	8.00%	N/A	N/A
BankFinancial, NA	168,113	14.72	91,386	8.00	\$114,232	10.00 %
Tier 1 (core) capital (to risk-weighted assets):						
Consolidated	185,718	16.25	68,560	6.00	N/A	N/A
BankFinancial, NA	159,986	14.01	68,539	6.00	91,386	8.00
Common Tier 1 (CET1)						
Consolidated	185,718	16.25	51,420	4.50	N/A	N/A
BankFinancial, NA	159,986	14.01	51,404	4.50	74,251	6.50
Tier 1 (core) capital (to adjusted average total assets):						
Consolidated	185,718	11.92	62,306	4.00	N/A	N/A
BankFinancial, NA	159,986	10.27	62,303	4.00	77,879	5.00

Capital Management - Company. Total stockholders' equity was \$199.8 million at September 30, 2017, compared to \$204.8 million at December 31, 2016. The decrease in total stockholders' equity was due to the combined impact of our repurchase of 614,673 shares of our common stock during the first nine months of 2017 at a total cost of \$9.1 million, our declaration and payment of cash dividends totaling \$3.7 million during the same period, and the \$1.2 million net impact of stock option exercises. These items were partially offset by the net income of \$8.0 million that we recorded for the nine months ended September 30, 2017 and the \$1.1 million impact of the ESOP loan repayment on March 29, 2017.

Quarterly Cash Dividends. The Company declared cash dividends of \$0.20 and \$0.15 per share for the nine months ended September 30, 2017 and September 30, 2016, respectively.

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Stock Repurchase Program. During the quarter ending September 30, 2017, the Company repurchased 166,237 shares of its common stock. As of September 30, 2017, the Company had repurchased 2,482,879 shares of its common stock out of the 2,830,755 shares of common stock authorized under the share repurchase authorizations. The Board increased the share repurchase authorization by 250,000 shares to its current level on July 27, 2017. The share repurchase authorization will expire on December 31, 2017 unless further extended by the Board.

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

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

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

We actively evaluate interest rate risk in connection with our lending, investing and deposit activities. In an effort to better manage interest-rate risk, we have de-emphasized the origination of residential mortgage loans, and have increased our emphasis on the origination of nonresidential real estate loans, multi-family mortgage loans, commercial loans and commercial leases. In addition, depending on market interest rates and our capital and liquidity position, we generally sell all or a portion of our longer-term, fixed-rate residential loans, usually on a servicing-retained basis. Further, we primarily invest in shorter-duration securities, which generally have lower yields compared to longer-term investments. Shortening the average maturity of our interest-earning assets by increasing our investments in shorter-term loans and securities, as well as loans with variable rates of interest, helps to better match the maturities and interest rates of our assets and liabilities, thereby reducing the exposure of our net interest income to changes in market interest rates. Finally, we have classified all of our investment portfolio as available-for-sale so as to provide flexibility in liquidity management.

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

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

Our dynamic GAP analysis determines the relative balance between the repricing of assets and liabilities over multiple periods of time (ranging from overnight to five years). Dynamic GAP analysis includes expected cash flows from loans and mortgage-backed securities, applying prepayment rates based on the differential between the current interest

rate and the market interest rate for each loan and security type. This analysis identifies mismatches in the timing of asset and liability repricing but does not necessarily provide an accurate indicator of interest rate risk because it omits the factors incorporated into the net interest income analysis.



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Quantitative Analysis. The following table sets forth, as of September 30, 2017, the estimated changes in the Bank's NPV and net interest income that would result from the designated instantaneous parallel shift in the U.S. Treasury yield curve. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

Change in Interest Rates (basis points)	Estimated Decrease in NPV		Increase (Decrease) in Estimated Net Interest Income	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
+400	\$(19,288)	(7.68)%	\$ 4,055	7.97 %
+300	(6,644 )	(2.65)	3,169	6.23
+200	1,771	0.71	2,293	4.51
+100	6,259	2.49	1,231	2.42
0				
-25	4,021	1.60	(791 )	(1.55 )

The table set forth above indicates that at September 30, 2017, in the event of an immediate 25 basis point decrease in interest rates, the Bank would be expected to experience a 1.60% decrease in NPV and a \$791,000 decrease in net interest income. In the event of an immediate 200 basis point increase in interest rates, the Bank would be expected to experience a 0.71% increase in NPV and a \$2.3 million increase in net interest income. This data does not reflect any actions that we may undertake in response to changes in interest rates, such as changes in rates paid on certain deposit accounts based on local competitive factors, which could reduce the actual impact on NPV and net interest income, if any.

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

**ITEM 4. CONTROLS AND PROCEDURES**

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chairman, Chief Executive Officer and President and the Executive Vice President and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of September 30, 2017. Based on that evaluation, the Company's management, including the Chairman, Chief Executive Officer, and President and the Executive Vice President and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective.

During the quarter ended September 30, 2017, there have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



## PART II

## ITEM 1. LEGAL PROCEEDINGS

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

## ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors previously disclosed in the Company's filings with the Securities and Exchange Commission.

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

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

(b) Use of Proceeds. Not applicable.

(c) Repurchases of Equity Securities.

The following table sets forth information in connection with purchases of our common stock made by, or, on behalf of us, during the third quarter of 2017:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased under the Plans or Programs (1)
July 1, 2017 through July 31, 2017	66,659	\$ 14.97	66,659	447,454
August 1, 2017 through August 31, 2017	53,770	15.72	53,770	393,684
September 1, 2017 through September 30, 2017	45,808	15.91	45,808	347,876
	166,237		166,237	

(1) On July 27, 2017, the Board increased the total number of shares authorized by 250,000 under the Company's current share repurchase authorization which expires December 31, 2017. As of September 30, 2017, the Company had repurchased 2,482,879 shares of its common stock out of the 2,830,755 shares of common stock authorized under the share repurchase authorizations.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION

None.

## ITEM 6. EXHIBITS

Exhibit Number	Description
<u>10.1</u>	Amendment No. 2 to the Amended and Restated Employment Agreement Between BankFinancial Corporation with F. Morgan Gasior (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K, filed on August 1, 2017)
<u>10.2</u>	Amendment No. 2 to the Amended and Restated Employment Agreement Between BankFinancial Corporation with Paul A. Cloutier (Incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K, filed on August 1, 2017)
<u>10.3</u>	Amendment No. 2 to the Amended and Restated Employment Agreement Between BankFinancial Corporation with James J. Brennan (Incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K, filed on August 1, 2017)
<u>31.1</u>	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<u>31.2</u>	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<u>32</u>	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
101	The following financial statements from the BankFinancial Corporation Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, formatted in Extensive Business Reporting Language (XBRL): (i) consolidated statement of conditions, (ii) consolidated statements of operations, (iii) consolidated statements of cash flows and (iv) the notes to consolidated financial statements.

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

SIGNATURES

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

BANKFINANCIAL  
CORPORATION

Dated: October 25, 2017 By: /s/ F. Morgan Gasior

F. Morgan Gasior  
Chairman of the  
Board, Chief  
Executive Officer and  
President

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