
**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, 2005

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 its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

15W060 North Frontage Road, Burr Ridge, Illinois
(Address of principal executive offices)

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

60527
(Zip Code)

Registrant's telephone number including area code: (630) 242-7700

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 is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No .

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No .

Indicate the number of shares outstanding of each of the Issuer's class of common stock as of the latest practicable date.

24,466,250 shares of Common Stock, par value \$0.01 per share, were issued and outstanding as of November 3, 2005.

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BANKFINANCIAL CORPORATION

Form 10-Q Quarterly Report

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PART I

ITEM 1. FINANCIAL STATEMENTS

BANKFINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Dollars in thousands, except per share data) – (Unaudited)

| | September 30, 2005 | December 31, 2004 |
|--|-----------------------|----------------------|
| ASSETS | | |
| Cash and due from other financial institutions | \$ 28,016 | \$ 27,867 |
| Interest-bearing deposits in other financial institutions | 54,373 | 1,431 |
| Cash and cash equivalents | 82,389 | 29,298 |
| Securities available-for-sale, at fair value | 258,981 | 268,093 |
| Loans held-for-sale | 523 | 5,531 |
| Loans receivable, net of allowance for loan losses: | | |
| September 30, 2005, \$10,931; and December 31, 2004, \$11,019 | 1,135,709 | 1,091,952 |
| Stock in Federal Home Loan Bank, at cost | 25,197 | 24,226 |
| Premises and equipment, net | 32,810 | 32,954 |
| Accrued interest receivable | 6,170 | 5,420 |
| Goodwill | 10,865 | 10,865 |
| Core deposit intangible | 8,653 | 9,882 |
| Other assets | 11,783 | 14,561 |
| Total assets | \$ 1,573,080 | \$ 1,492,782 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities | | |
| Deposits | 1,044,242 | 1,115,696 |
| Borrowings | 181,252 | 264,742 |
| Advance payments by borrowers taxes and insurance | 10,844 | 7,074 |
| Accrued interest payable and other liabilities | 11,416 | 10,382 |
| Total liabilities | 1,247,754 | 1,397,894 |
| Commitments and contingent liabilities | | |
| Stockholders' equity | | |
| Preferred Stock, \$0.01 par value, 25,000,000 shares authorized, none issued or outstanding | — | — |
| Common Stock, \$0.01 par value, 100,000,000 shares authorized, 24,466,250 shares issued and outstanding, at September 30, 2005, none issued and outstanding at December 31, 2004 | 245 | — |
| Additional paid-in capital | 240,123 | — |
| Retained earnings | 104,609 | 96,455 |
| Unearned Employee Stock Ownership Plan shares | (19,319) | — |
| Accumulated other comprehensive loss | (332) | (1,567) |
| Total stockholders' equity | 325,326 | 94,888 |
| Total liabilities and stockholders' equity | \$ 1,573,080 | \$ 1,492,782 |

See accompanying notes to consolidated financial statements.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-------------------|------------------------------------|-----------------|
| | 2005 | 2004 | 2005 | 2004 |
| Interest and dividend income | | | | |
| Loans, including fees | \$16,950 | \$14,307 | \$48,231 | \$41,649 |
| Securities | 3,229 | 2,033 | 8,981 | 5,905 |
| Other | 538 | 379 | 1,600 | 1,145 |
| Total interest income | 20,717 | 16,719 | 58,812 | 48,699 |
| Interest expense | | | | |
| Deposits | 5,084 | 3,771 | 14,746 | 9,965 |
| Borrowings | 1,755 | 1,922 | 6,502 | 7,278 |
| Total interest expense | 6,839 | 5,693 | 21,248 | 17,243 |
| Net interest income | 13,878 | 11,026 | 37,564 | 31,456 |
| Provision (credit) for loan losses | 334 | (212) | (6) | (212) |
| Net interest income after provision (credit) for loan losses | 13,544 | 11,238 | 37,570 | 31,668 |
| Noninterest income | | | | |
| Fees and service charges | 1,623 | 1,434 | 4,393 | 4,012 |
| Insurance commissions and annuities income | 265 | 181 | 606 | 561 |
| Gain on sale of loans | 50 | 58 | 179 | 216 |
| Gain on sale of securities | — | — | — | 419 |
| Loan servicing fees | 257 | 263 | 782 | 722 |
| Amortization and impairment of servicing assets | (73) | (208) | (526) | (515) |
| Operations of real estate owned | (1) | 405 | 4 | 487 |
| Other | 413 | 219 | 983 | 762 |
| Total noninterest income | 2,534 | 2,352 | 6,421 | 6,664 |
| Noninterest expense | | | | |
| Compensation and benefits | 7,335 | 6,261 | 20,829 | 19,487 |
| Office occupancy and equipment | 1,275 | 1,213 | 3,681 | 3,806 |
| Advertising and public relations | 177 | 195 | 625 | 641 |
| Data processing | 777 | 632 | 2,153 | 2,047 |
| Supplies, telephone, and postage | 490 | 449 | 1,433 | 1,475 |
| Amortization of intangibles | 410 | 426 | 1,229 | 1,279 |
| Loss on impairment of securities available for sale | — | 5,500 | — | 5,500 |
| Other | 927 | 929 | 2,746 | 2,743 |
| Total noninterest expense | 11,391 | 15,605 | 32,696 | 36,978 |
| Income (loss) before income taxes | 4,687 | (2,015) | 11,295 | 1,354 |
| Income tax expense (benefit) | 990 | (969) | 3,141 | (7) |
| Net income (loss) | \$ 3,697 | \$ (1,046) | \$ 8,154 | \$ 1,361 |
| Earnings per Basic and Diluted Share | \$ 0.16 | N.M. | \$ 0.16 | N.M. |

N.M. = Not Meaningful

See accompanying notes to consolidated financial statements.

BANKFINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY AND
COMPREHENSIVE INCOME (LOSS)
(In thousands) - (Unaudited)

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Unearned Employee Stock Ownership Plan Shares | Accumulated Other Comprehensive Income (Loss) | Total | Comprehensive Income (Loss) |
|---|-----------------|----------------------------------|----------------------|---|--|------------|--------------------------------|
| Balance at December 31, 2003 | \$ — | \$ — | \$ 94,998 | \$ — | \$ 1,689 | \$ 96,687 | |
| Comprehensive income | | | | | | | |
| Net income | — | — | 1,361 | — | — | 1,361 | \$ 1,361 |
| Change in other comprehensive income (loss), net of tax effects | — | — | — | — | (4,004) | (4,004) | (4,004) |
| Total comprehensive income (loss) | | | | | | | \$ (2,643) |
| Balance at September 30, 2004 | \$ — | \$ — | \$ 96,359 | \$ — | \$ (2,315) | \$ 94,044 | |
| Balance at December 31, 2004 | \$ — | \$ — | \$ 96,455 | \$ — | \$ (1,567) | \$ 94,888 | |
| Comprehensive income | | | | | | | |
| Net income | — | — | 8,154 | — | — | 8,154 | \$ 8,154 |
| Change in other comprehensive income (loss), net of tax effects | — | — | — | — | 1,235 | 1,235 | 1,235 |
| Total comprehensive income | | | | | | | \$ 9,389 |
| Net proceeds from common stock issued | 245 | 240,007 | — | (19,573) | — | 220,679 | |
| ESOP shares earned | — | 116 | — | 254 | — | 370 | |
| Balance at September 30, 2005 | \$ 245 | \$ 240,123 | \$ 104,609 | \$ (19,319) | \$ (332) | \$ 325,326 | |

See accompanying notes to consolidated financial statements.

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

| | Nine Months Ended September 30, | |
|--|------------------------------------|-----------|
| | 2005 | 2004 |
| Cash flows from operating activities | | |
| Net income | \$ 8,154 | \$ 1,361 |
| Adjustments to reconcile to net income to net cash from operating activities | | |
| Credit for loan losses | (6) | (212) |
| ESOP shares earned | 370 | — |
| Depreciation and amortization | 2,658 | 2,644 |
| Net gain on sale of securities | — | (419) |
| Net change in premiums and discounts | 277 | 186 |
| Amortization of premium on early extinguishment of debt | 388 | 2,324 |
| Amortization of core deposit and other intangible assets | 1,385 | 2,316 |
| Impairment of securities available-for-sale | — | 5,500 |
| Amortization and impairment of servicing assets | 526 | 515 |
| Net change in net deferred loan origination costs | (259) | (340) |
| Net gain on sale of real estate owned | — | (542) |
| Net gain on sale of loans | (179) | (216) |
| Loans originated for sale | (13,569) | (39,658) |
| Proceeds from sale of loans | 18,756 | 39,738 |
| Federal Home Loan Bank of Chicago stock dividends | (971) | (1,062) |
| Net change in: | | |
| Deferred income tax | 189 | (171) |
| Accrued interest receivable | (750) | (2) |
| Other assets | 426 | 460 |
| Accrued interest payable and other liabilities | 1,034 | 1,837 |
| Net cash from operating activities | 18,429 | 14,259 |
| Cash flows from investing activities | | |
| Securities available-for-sale | | |
| Proceeds from sales | — | 10,551 |
| Proceeds from maturities | 9,946,874 | 345 |
| Proceeds from principal repayments | 34,974 | 35,846 |
| Purchase of securities | (9,946,609) | (1,510) |
| Loans receivable | | |
| Principal payments on loans receivable | 327,997 | 345,034 |
| Purchases | (76,529) | (87,091) |
| Originated for investment | (319,472) | (328,837) |
| Proceeds from sale of real estate owned | — | 2,733 |
| Purchase of premises and equipment, net | (1,690) | (1,505) |
| Net cash from investing activities | (34,455) | (24,434) |

(Continued)

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

| | Nine Months Ended September 30, | |
|---|------------------------------------|------------------|
| | 2005 | 2004 |
| Cash flows from financing activities | | |
| Net change in deposits | (71,454) | 51,180 |
| Net change in advance payments by borrowers for taxes and insurance | 3,770 | 3,122 |
| Net change in borrowings | (83,878) | (41,089) |
| Net proceeds from sale of common stock | 220,679 | — |
| Net cash from financing activities | 69,117 | 13,213 |
| Net change in cash and cash equivalents | 53,091 | 3,038 |
| Beginning cash and cash equivalents | 29,298 | 28,630 |
| Ending cash and cash equivalents | \$ 82,389 | \$ 31,668 |
| Supplemental disclosures: | | |
| Interest paid | \$ 20,783 | \$ 15,058 |
| Income taxes paid | 2,710 | — |
| Loans transferred to real estate owned | — | 557 |
| Loans securitized | 24,213 | 60,369 |

See accompanying notes to consolidated financial statements.

BANKFINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Table dollar amounts in thousands, except dollars per share)
(unaudited)

Note 1 – Basis of Presentation.

BankFinancial Corporation, a Maryland corporation organized in 2004, became the owner of all of the issued and outstanding capital stock of BankFinancial F.S.B. (the “Bank”) on June 23, 2005, upon the consummation of a plan of conversion and reorganization adopted by the predecessor holding companies for the Bank, BankFinancial MHC, Inc. (“BankFinancial MHC”) and BankFinancial Corporation, a federal corporation.

Pursuant to the plan of conversion and reorganization, BankFinancial MHC converted from the mutual form of ownership to the stock form of ownership through a series of transactions that terminated the separate corporate existences of BankFinancial MHC and BankFinancial Corporation, the federal corporation. BankFinancial Corporation, the Maryland corporation, then sold 24,466,250 shares of common stock in a subscription offering for \$10.00 per share, and became the sole stockholder of the Bank. For a further discussion of BankFinancial Corporation, the Maryland corporation, and the operations of BankFinancial MHC, BankFinancial Corporation, the federal corporation, and the Bank for certain periods prior to the consummation of the conversion and reorganization, see the Company’s Prospectus as filed on April 29, 2005 with the Securities and Exchange Commission pursuant to Rule 424(b)(3) of the Rules and Regulations of the Securities Act of 1933 (File Number 333-119217).

BankFinancial Corporation, the Maryland corporation, did not engage in any business prior to the consummation of the conversion and reorganization on June 23, 2005. Consequently, the accompanying 2005 unaudited consolidated financial statements reflect the financial condition and operating results of BankFinancial MHC, Inc., BankFinancial Corporation, the federal corporation, and their subsidiaries until June 23, 2005, and of BankFinancial Corporation, the Maryland corporation, and its subsidiaries thereafter. The words “Company,” “we” and “our” are therefore intended to refer to BankFinancial MHC, BankFinancial Corporation, the federal corporation, and their subsidiaries, including the Bank, with respect to matters and time periods occurring on or before June 23, 2005, and to refer to BankFinancial Corporation, the Maryland corporation, and its subsidiaries, including the Bank, with respect to matters and time periods occurring thereafter.

The accompanying interim unaudited consolidated financial statements include the accounts of and transactions of BankFinancial MHC, Inc., BankFinancial Corporation, the federal corporation, BankFinancial Corporation, the Maryland corporation, the Bank, and the Bank’s wholly-owned subsidiaries, Financial Assurance Services, Inc. and BankFinancial Asset Recovery Corporation (collectively, “the Company”). All significant intercompany accounts and transactions have been eliminated.

The interim unaudited consolidated financial statements 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. The results of operations for the three-month and nine-month periods ended September 30, 2005, are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2005.

Certain information and note disclosures normally included in financial statements and prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission.

Certain prior period amounts have been reclassified to correspond with the current period presentations.

To prepare financial statements in conformity with U.S. generally accepted accounting principles, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, loan servicing rights, impairment of securities and the fair value of investment securities and financial instruments are particularly subject to change.

BANKFINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Table dollar amounts in thousands, except dollars per share)
(unaudited)

These unaudited consolidated financial statements should be read in conjunction with the Company's Prospectus as filed on April 29, 2005 with the Securities and Exchange Commission pursuant to Rule 424(b)(3) of the Rules and Regulations of the Securities Act of 1933 (File Number 333-119217).

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. Therefore, earnings per share reported for the nine months ended September 30, 2005 reflects income only for the period during which shares were outstanding.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|-----------|------------------------------------|---------|
| | 2005 | 2004 | 2005 | 2004 |
| Net income | \$ 3,697 | \$(1,046) | \$ 8,154 | \$1,361 |
| Less: net income before conversion | — | (1,046) | 4,457 | 1,361 |
| Net income available to common stockholders | \$ 3,697 | \$ — | \$ 3,697 | \$ — |
| Average common shares outstanding | 24,466,250 | — | 24,466,250 | — |
| Less: Unearned ESOP shares | (1,935,652) | — | (1,935,652) | — |
| Weighted average common shares outstanding | 22,530,598 | — | 22,530,598 | — |
| Basic earnings per share | \$ 0.16 | N.M. | \$ 0.16 | N.M. |
| Diluted earnings per share | \$ 0.16 | N.M. | \$ 0.16 | N.M. |

N.M. - not meaningful

BANKFINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Table dollar amounts in thousands, except dollars per share)
(unaudited)

Note 3 – Securities

The fair value of securities available-for-sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) are as follows:

| | <u>Fair Value</u> | <u>Gross Unrealized Gains</u> | <u>Gross Unrealized Losses</u> |
|--|-------------------|---------------------------------------|--|
| September 30, 2005 | | | |
| State and municipal securities | \$ 3,194 | 3 | (14) |
| Mortgage-backed securities | 166,186 | 325 | (2,997) |
| Collateralized mortgage obligations | 1,655 | 27 | — |
| SBA-guaranteed loan participation certificates | 1,877 | 1 | (6) |
| Equity securities | 86,069 | 3,469 | (1,360) |
| | <u>\$258,981</u> | <u>\$ 3,825</u> | <u>\$ (4,377)</u> |
| December 31, 2004 | | | |
| State and municipal securities | \$ 3,464 | \$ 7 | \$ (13) |
| Mortgage-backed securities | 178,668 | 696 | (1,660) |
| Collateralized mortgage obligations | 1,700 | 27 | — |
| SBA-guaranteed loan participation certificates | 1,941 | 1 | (18) |
| Equity securities | 82,320 | 235 | (1,875) |
| | <u>\$268,093</u> | <u>\$ 966</u> | <u>\$ (3,566)</u> |

Mortgage-backed securities and collateralized mortgage obligations consist of Freddie Mac, Fannie Mae and Ginnie Mae issues. Equity securities consist primarily of Fannie Mae and Freddie Mac floating rate preferred stocks.

Interest income on securities is recognized under the interest method, and includes amortization of purchase premium and discount. Gains and losses on sales of securities are based on the amortized cost of the securities sold. Declines in the fair value of securities below their cost that are considered other-than-temporarily impaired are reflected as realized losses. In determining whether unrealized losses constitute other-than-temporary impairments, management considers all relevant factors, including: (1) the length of time and the extent that fair value has been less than cost or adjusted cost, as applicable, (2) the projected value of the security in future periods, (3) the likelihood of a recovery of the carrying value of the security, (4) the financial condition and near-term prospects of the issuer, and (5) the Company's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

The Company evaluates its investment securities with significant declines in fair value on a quarterly basis to determine whether they should be considered temporarily or other-than-temporarily impaired.

We evaluated the unrealized losses on certain investments in state and municipal bonds, mortgage-backed securities and SBA guaranteed loan participation certificates, and concluded that they were primarily attributable to increases in interest rates rather than credit quality or other issuer-specific factors. Since the Company has the ability and intent to hold these investments until a recovery occurs or the securities mature, and the carrying cost is projected to recover as market interest rates change, we did not consider the unrealized losses on these investments to be other-than-temporary impairments.

BANKFINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Table dollar amounts in thousands, except dollars per share)
(unaudited)

We use financial modeling to conduct impairment testing on marketable equity securities with dividends that adjust periodically based on market interest rate indices, such as the Fannie Mae and Freddie Mac floating rate preferred stocks included in equity securities. We initially determine the severity of the impairment and the continuous duration of the impairment (generally, as well as the continuous duration of any impairment exceeding 5%). Using our valuation model, we then prepare a projection of the value of each security in future periods using current data and mean and median historical data as inputs for the model's forward yield curve and volatility curve parameters, and for each security, its original, current and mid-point spread over the applicable risk-free benchmark since time of issuance. The projection results are used to assess the likelihood of a recovery of the carrying value of the security, using criteria that require greater evidence of a full recovery as the duration and, particularly, the severity of an impairment increase, and considering any other evidence that is relevant to the issue of recovery. Acting on the premise that a write-down may be required, we evaluate the model results together with other relevant evidence and make a judgment as to whether the evidence favors a full recovery, and whether the Company has the intent and ability to hold the security for the duration of the forecasted recovery period. In the absence of other relevant evidence, the model results will generally be controlling. If other relevant evidence exists, the model results will not necessarily be controlling, and are weighed with the other relevant evidence.

We conducted impairment testing during each quarter of 2005 and concluded that unrealized losses that existed on certain of our Fannie Mae and Freddie Mac floating rate preferred stocks did not constitute other-than-temporary impairments. We therefore did not record an impairment loss for the three- or nine-month period ended September 30, 2005. The nine-month period ended September 30, 2004, included a \$5.5 million impairment loss, pre-tax, that we recorded for unrealized losses that existed at the end of such period with respect to our holdings in a Freddie Mac floating rate preferred stock issue.

Note 4 – Loans Receivable

Loans that management has the intent and ability to hold until maturity or payment in full are reported at the aggregate principal balance outstanding, net of the allowance for loan losses, premiums and discounts on loans purchased, and net deferred loan costs. Interest income on loans is recognized into income over the term of the loan based on the amount of principal outstanding.

Loans originated are identified as either held for sale or held for investment and accounted for accordingly upon their origination. Loans that have been classified as held for sale are recorded at the lower of their aggregate cost or market value. The Company sells a portion of its mortgage loan production in the secondary market. The Company obtains sales commitments on certain of these loans immediately prior to making the origination commitment. Net unrealized losses are recognized by charges to income.

Premiums and discounts associated with loans purchased are amortized over the expected life of the loan using the level-yield method.

Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the contractual loan term, adjusted for prepayments. Interest income is discontinued at the time a loan becomes 90 days delinquent unless the loan is well secured and is in process of collection. In all cases, loans are placed on nonaccrual status or are charged off at an earlier date if we consider the collection of principal or interest to be doubtful.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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BANKFINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Table dollar amounts in thousands, except dollars per share)
(unaudited)

Loans receivable are as follows:

| | September 30, 2005 | December 31, 2004 |
|---|-----------------------|----------------------|
| One- to four-family residential real estate | \$ 396,549 | \$ 363,097 |
| Multi-family mortgage loans | 241,775 | 240,607 |
| Nonresidential real estate | 259,499 | 269,581 |
| Construction and land loans | 76,953 | 59,784 |
| Commercial loans | 69,581 | 71,821 |
| Commercial leases | 92,268 | 86,362 |
| Consumer loans | 1,975 | 2,755 |
| Other loans (including municipal) | 5,492 | 6,044 |
| Total loans | 1,144,092 | 1,100,051 |
| Loans in process | 193 | 824 |
| Net deferred loan origination costs | 2,355 | 2,096 |
| Allowance for loan losses | (10,931) | (11,019) |
| Loans, net | \$ 1,135,709 | \$ 1,091,952 |

Activity in the allowance for loan losses is as follows:

| | Nine months ended September 30, | |
|------------------------|------------------------------------|------------------|
| | 2005 | 2004 |
| Beginning balance | \$ 11,019 | \$ 12,034 |
| Credit for loan losses | (6) | (212) |
| Loans charged off | (86) | (1,371) |
| Recoveries | 4 | 399 |
| Ending balance | \$ 10,931 | \$ 10,850 |

Impaired loans are as follows:

| | September 30, 2005 | December 31, 2004 |
|--|-----------------------|----------------------|
| Loans with allocated allowance for loan losses | \$ 7,802 | \$ 9,491 |
| Loans with no allocated allowance for loan losses | 6,633 | 7,575 |
| Total | \$ 14,435 | \$ 17,066 |
| Amount of the allowance for loan losses allocated | \$ 1,805 | \$ 2,056 |

BANKFINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Table dollar amounts in thousands, except dollars per share)
(unaudited)

Nonperforming loans are as follows:

| | September 30, 2005 | December 31, 2004 |
|--|-----------------------|----------------------|
| Loans past due over 90 days still on accrual | \$ — | \$ — |
| Nonaccrual loans | 7,280 | 6,524 |
| Restructured loans | 3,721 | — |

The restructured loans reflected above are also included in the nonaccrual loan amount totals. Although the loans were current as to all scheduled payments as of September 30, 2005, the loans will remain on nonaccrual status until the borrowers achieve a sustained period of payment performance, and until then, all interest payments made on the two loans will be recorded on a cash basis as received.

If the nonperforming loans had performed in accordance with their original terms, interest income would have been increased by \$482,000 and \$524,000 for the nine-month periods ended September 30, 2005 and 2004, respectively.

Nonperforming loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The allowance for loan losses is a valuation allowance for probable loan losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations, estimated collateral values, economic conditions, and other relevant factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors.

A loan is impaired when full payment under the loan terms is not expected. Multi-family mortgage loans, nonresidential real estate, construction and land loans, and commercial loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

Loan commitments are considered in determining the provision for loan losses. The Company has not recorded any provision for losses on loan commitments because no such losses were probable and reasonably estimable.

BANKFINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Table dollar amounts in thousands, except dollars per share)
(unaudited)

Note 5 – Deposits

Deposits are as follows:

| | September 30, 2005 | December 31, 2004 |
|-----------------------------|-----------------------|----------------------|
| Non-interest-bearing demand | \$ 109,022 | \$ 104,448 |
| Interest-bearing NOW | 219,457 | 232,968 |
| Money market | 236,285 | 205,933 |
| Savings | 122,783 | 132,009 |
| Certificates of deposit | 356,695 | 440,338 |
| | <u>\$ 1,044,242</u> | <u>\$ 1,115,696</u> |

Included in certificates of deposit are \$9.8 million and \$23.9 million of brokered deposits at September 30, 2005 and December 31, 2004, respectively. All brokered deposits are over \$100,000.

Interest expense on deposit accounts is summarized as follows for the periods indicated:

| | Nine months ended September 30, | |
|-------------------------|------------------------------------|----------------|
| | 2005 | 2004 |
| Interest-bearing NOW | \$ 1,645 | \$ 841 |
| Money market accounts | 4,218 | 1,687 |
| Savings | 767 | 572 |
| Certificates of deposit | 8,116 | 6,865 |
| | <u>\$14,746</u> | <u>\$9,965</u> |

Note 6 – Employee Benefit Plans

Employee Stock Ownership Plan (ESOP). The Bank established an ESOP for its employees effective January 1, 2004. The ESOP covers all eligible employees of the Bank and its subsidiaries. Employees are eligible to participate in the ESOP after attainment of age 21 and completion of one year of service. In connection with the conversion and reorganization, the ESOP borrowed \$19.6 million from the Company, and used the proceeds of the loan to purchase 1,957,300 common shares issued in the subscription offering at \$10.00 per share. The loan is secured by shares purchased with the loan proceeds and will be repaid by the ESOP with funds from the Bank's discretionary contributions to the ESOP and earnings on ESOP assets. The Bank has committed to make discretionary contributions to the ESOP sufficient to service the loan over a period not to exceed 20 years. Expense related to the ESOP was \$370,000 and \$0 for the nine months ended September 30, 2005 and 2004, respectively.

BANKFINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Table dollar amounts in thousands, except dollars per share)
(unaudited)

Note 7– Other Comprehensive Income (Loss)

Other comprehensive income (loss) components were as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------------|------------------------------------|------------|
| | 2005 | 2004 | 2005 | 2004 |
| Net income (loss) | \$ 3,697 | \$ (1,046) | \$ 8,154 | \$ 1,361 |
| Unrealized holding gains (losses) on securities available-for-sale, net of tax effects | (921) | (3,563) | 1,235 | (7,066) |
| Less reclassification adjustment for gains recognized in income, net of tax | — | — | — | (252) |
| Loss on impairment of securities available - for-sale, net of tax | — | 3,314 | — | 3,314 |
| Net change in other comprehensive income (loss) of tax effects | (921) | (249) | 1,235 | (4,004) |
| Total comprehensive income (loss) | \$ 2,776 | \$ (1,295) | \$ 9,389 | \$ (2,643) |

Note 8 – New Accounting Standards

The Financial Accounting Standards Board issued Statement 123R, “Share-Based Payment,” that would be effective for all employee share awards granted, modified, or settled after January 1, 2006 for calendar year-end companies. As of the effective date, compensation expense related to the non-vested portion of any awards outstanding as of that date would be based on the grant-date fair value as calculated under the original provisions of Statement 123. Adoption of Statement 123R would materially increase the amount of compensation and benefits expense that would be incurred for any awards that we grant, modify or settle after January 1, 2006. The Company does not currently have a share award program.

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

Cautionary Statement Regarding Forward-Looking Information

This report, including Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," contains, and other periodic reports and press releases of the Company 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. The Company intends such 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 is including this statement for purposes of invoking these safe harbor provisions. These forward-looking statements, which are based on certain assumptions and describe future plans, strategies and expectations of the Company, are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "estimate," "project," "plan," or similar expressions. The Company's ability to predict results or the actual effect of future plans or strategies is inherently uncertain and actual results may differ from those predicted. The Company undertakes no obligation to update these forward-looking statements in the future. Factors that could have a material adverse effect on operations and could affect management's outlook or future prospects of the Company and its subsidiaries include, but are not limited to: higher than expected overhead, infrastructure and compliance costs, changes in market interest rates or further flattening of the yield curve, less than anticipated balance sheet growth, lack of demand for loan products, unanticipated changes in secondary mortgage market conditions, deposit flows, competition, adverse federal or state legislative or regulatory developments, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and Federal Reserve Board, deteriorating economic conditions that could result in increased delinquencies in the Company's loan portfolio, the quality or composition of the Company's loan or investment portfolios, demand for financial services and multi-family, commercial and residential real estate loans in the Company's market area, the possible short-term dilutive effect of potential acquisitions or de novo branches, if any, changes in accounting principles, policies and guidelines, and future adverse developments concerning Freddie Mac, Fannie Mae, or the Federal Home Loan Bank of Chicago. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

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 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 included in the Company's Prospectus as filed on April 29, 2005 with the Securities and Exchange Commission pursuant to Rule 424(b)(3) of the Rules and Regulations of the Securities Act of 1933 (File Number 333-119217).

Overview

Our mutual to stock conversion was consummated on June 23, 2005. The net proceeds of the subscription offering totaled \$220.7 million, excluding the \$19.6 million in stock purchased by our ESOP. The subscription offering was over-subscribed, and we issued subscription order refunds, including interest, totaling \$192.5 million, of which \$167.1 million was refunded through the issuance of refund checks, and \$25.4 million was refunded through releases of deposit account holds. Substantially all of the subscription order refunds had been paid as of September 30, 2005. The cash inflows resulting from the subscription orders and the cash outflows resulting from subscription order refunds affected various items in our financial statements during the nine months ended September 30, 2005. The effects of the portion of the subscription offering proceeds that was subsequently refunded to subscribers were primarily transitory in nature.

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Our results of operations depend primarily on our net interest income. Net interest income is the difference between the interest income we earn on our interest-earning assets, consisting primarily of loans, investment securities and other interest-earning assets, and the interest we pay on our interest-bearing liabilities, consisting primarily of NOW accounts, savings accounts, money market accounts, time deposits and Federal Home Loan Bank borrowings.

Our provisions for loan losses, non-interest income and non-interest expense also affect our results of operations. Non-interest income consists primarily of fees and service charges, income from the sale of annuities and insurance, and miscellaneous other income. Non-interest expense consists primarily of expenses for compensation and employee benefits, occupancy and equipment, data processing, professional services, advertising and other general and administrative items. Our results of operations also may be affected significantly by general and local economic and competitive conditions, changes in market interest rates, governmental policies and actions of regulatory authorities.

Net income increased \$6.8 million to \$8.2 million for the nine months ended September 30, 2005, from \$1.4 million for the nine-month period ended September 30, 2004.

Net interest income increased by \$6.1 million, or 19.4%, to \$37.6 million for the nine months ended September 30, 2005, from \$31.5 million for the nine months ended September 30, 2004. The increase in net interest income was primarily attributable to a \$121.8 million increase in average earning assets and a 30 basis point increase in our net interest margin. Our net interest rate spread improved to 3.02% for the nine months ended September 30, 2005, from 2.87% for the nine months ended September 30, 2004. The nine months ended September 30, 2005 included approximately \$450,000 of net interest rate spread earned on \$167.1 million in subscription orders receipts that, at September 30, 2005, have been substantially refunded to subscribers.

Interest income increased \$10.1 million, or 20.8%, to \$58.8 million for the nine months ended September 30, 2005, from \$48.7 million for the nine months ended September 30, 2004. The increase in interest income resulted primarily from a \$6.6 million increase in interest income on loans, and a \$3.1 million increase in interest income on investment securities. The increase in interest income on investment securities was principally due to the investment of the net proceeds of the subscription offering, which totaled \$220.7 million. Interest expense increased \$4.0 million, or 23.2%, to \$21.3 million for the nine months ended September 30, 2005, from \$17.2 million for the nine months ended September 30, 2004, primarily due to an increase in interest expense on deposit accounts. Interest income and interest expense each reflected the impact of utilizing the net proceeds of our subscription offering to increase earning assets, to retire term debt and to decrease wholesale deposits and Federal Home Loan Bank borrowings.

Noninterest income decreased \$243,000, or 3.6%, to \$6.4 million for the nine months ended September 30, 2005, from \$6.7 million for the same period in 2004. Noninterest expense decreased \$4.3 million, or 11.6%, to \$32.7 million for the nine months ended September 30, 2005, from \$37.0 million for the nine months ended September 30, 2004. Noninterest expense for the nine months ended September 30, 2004, included a \$5.5 million impairment loss, pre-tax, that we recorded in connection with our holdings in a Freddie Mac floating rate preferred stock issue. No securities impairment losses were recorded for the nine months ended September 30, 2005.

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The following tables summarize the major components of the changes in our balance sheet and income statement at and for the nine-month periods ended September 30, 2005 and 2004.

| | September 30, 2005 | December 31, 2004 | Percent Change |
|---|-----------------------|----------------------|-------------------|
| (Dollars in thousands) | | | |
| Selected Financial Condition Data: | | | |
| Total assets | \$ 1,573,080 | \$ 1,492,782 | 5.4% |
| Loans receivable, net | 1,135,709 | 1,091,952 | 4.0% |
| Deposits | 1,044,242 | 1,115,696 | (6.4)% |
| Stockholders' equity | 325,326 | 94,888 | 242.9% |
| (Dollars in thousands) | | | |
| For the nine months ended September 30, | | | |
| | 2005 | 2004 | Percent Change |
| Selected Operating Data: | | | |
| Interest income | \$58,812 | \$48,699 | 20.8% |
| Interest expense | 21,248 | 17,243 | 23.2 |
| Net interest income | 37,564 | 31,456 | 19.4 |
| Credit for loan losses | (6) | (212) | 97.2 |
| Net interest income after credit for loan losses | 37,570 | 31,668 | 18.6 |
| Noninterest income | 6,421 | 6,664 | (3.6) |
| Loss on impairment of securities available-for-sale | — | 5,500 | (100.0) |
| Other noninterest expense | 32,696 | 31,478 | 3.9 |
| Noninterest expense | 32,696 | 36,978 | (11.6) |
| Income before income taxes | 11,295 | 1,354 | 734.2 |
| Provision (benefit) for income taxes | 3,141 | (7) | N.M. |
| Net income | \$ 8,154 | \$ 1,361 | 499.1% |

Selected Financial Highlights

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|---------|------------------------------------|--------|
| | 2005 | 2004 | 2005 | 2004 |
| Selected Financial Ratios and Other Data: | | | | |
| Performance Ratios: | | | | |
| Return on assets (ratio of net income to average total assets) (1) | 0.92% | (0.28)% | 0.69% | 0.12% |
| Return on equity (ratio of net income to average equity) (1) | 4.57 | (4.35) | 5.94 | 1.92 |
| Net interest rate spread (1) (2) | 3.07 | 3.00 | 3.02 | 2.87 |
| Net interest margin (1) (3) | 3.65 | 3.18 | 3.34 | 3.05 |
| Average equity to average assets | 20.15 | 6.54 | 11.53 | 6.45 |
| Efficiency ratio (4) | 69.41 | 116.65 | 74.33 | 97.00 |
| Noninterest expense to average total assets (1) | 2.83 | 4.24 | 2.75 | 3.37 |
| Average interest-earning assets to average interest-bearing liabilities | 132.39 | 110.70 | 117.40 | 110.44 |

| | At September 30, 2005 | At December 31, 2004 |
|--|-----------------------------|----------------------------|
|--|-----------------------------|----------------------------|

| | | |
|--|--------|--------|
| Selected Financial Ratios and Other Data: | | |
| Asset Quality Ratios: | | |
| Nonperforming assets to total assets | 0.46% | 0.44% |
| Nonperforming loans to total loans | 0.63 | 0.59 |
| Allowance for loan losses to nonperforming loans | 150.15 | 168.90 |
| Allowance for loan losses to total loans | 0.96 | 1.00 |
| Capital Ratios: | | |
| Equity to total assets at end of period | 20.68 | 6.36 |
| Tier 1 leverage ratio (Bank only) | 13.96 | 7.12 |
| Other Data: | | |
| Number of full service offices | 16 | 16 |
| Full time equivalents | 449 | 446 |

(1) Ratios are 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.

Comparison of Financial Condition at September 30, 2005 and December 31, 2004

Our mutual to stock conversion was completed on June 23, 2005. We received subscription orders for 43.7 million shares of common stock, totaling \$436.8 million, and accepted subscription orders for 24,466,250 shares. The net proceeds of the subscription offering totaled \$220.7 million, excluding the \$19.6 million in common stock that our ESOP purchased. Of the \$436.8 million in subscription orders, holds placed on existing deposit accounts represented \$72.9 million and checks and other subscription order payments represented \$344.3 million. Subscription order payments were held in an interest bearing account at the Bank until the completion of the subscription offering. Thereafter, funds representing accepted subscription orders were paid to the Company, and funds due to subscribers for unfilled subscription orders were placed in a refund checking account at the Bank. We issued subscription order

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refunds, including interest, totaling \$192.5 million, of which \$167.1 million was refunded through the issuance of refund checks and \$25.4 million was refunded through releases of deposit account holds. As of September 30, 2005, substantially all of the subscription order refunds had been cashed by subscribers. The cash inflows from the subscription orders and the cash outflows from subscription order refunds affected various items in our financial statements during the nine months ended September 30, 2005. The effects of the portion of the subscription offering proceeds that we subsequently refunded to subscribers were primarily transitory in nature.

Total assets increased \$80.3 million, or 5.4%, to \$1.573 billion at September 30, 2005, from \$1.493 billion at December 31, 2004, primarily due to increases in cash and cash equivalents and net loans receivable. Cash and cash equivalents increased \$53.1 million to \$82.4 million at September 30, 2005, from \$29.3 at December 31, 2004. Net loans receivable increased by \$43.8 million, or 4.0%, to \$1.136 billion at September 30, 2005, from \$1.092 billion at December 31, 2004. Construction loans increased \$17.2 million during the first nine months of 2005, or 28.7%, due to increased originations and seasonal factors. Commercial loans and commercial leases increased \$3.7 million in the aggregate, or 2.3%, reflecting our continued emphasis on originating these types of loans. Multi-family mortgage loans and non-residential real estate loans decreased \$8.9 million, or 1.7%, primarily because the principal reductions on these types of loans slightly exceeded new loan originations during that period.

Securities available for sale decreased \$9.1 million, or 3.4%, to \$259.0 million at September 30, 2005, from \$268.1 million at December 31, 2004. The decrease reflects \$35.0 million of principal reductions on mortgage-backed securities. The principal reductions were partially offset by securitizations and increases in the fair value of certain securities. During the first nine months of 2005, we securitized \$24.2 million of adjustable-rate, one- to four-family residential real estate loans. The fair value of our portfolio of Fannie Mae and Freddie Mac floating rate preferred stocks increased \$3.8 million in the aggregate, or 4.9%, to \$81.3 million at September 30, 2005, from \$77.5 million at December 31, 2004, due to increases in the quoted market prices for certain of these securities since December 31, 2004.

Cash and cash equivalents increased \$53.1 million to \$82.4 million at September 30, 2005, from \$29.3 million at December 31, 2004. The increase was primarily due to the temporary investment of part of the subscription offering proceeds in interest bearing deposit accounts maintained with other institutions pending their redeployment into higher yielding assets.

Other assets decreased by \$2.8 million, or 19.1%, to \$11.8 million at September 30, 2005, from \$14.6 million at December 31, 2004. The decrease in other assets was partially due to a \$1.4 million decrease in deferred tax assets relating to an increase in the fair value of our portfolio of Fannie Mae and Freddie Mac floating rate preferred stocks, and the elimination of approximately \$800,000 in deferred expenses relating to the subscription offering by netting these expenses against the gross proceeds received from the subscription offering.

Deposits decreased \$71.5 million, or 6.4%, to \$1.044 billion at September 30, 2005, from \$1.116 billion at December 31, 2004. Certificates of deposit decreased \$83.6 million, or 19.0%, to \$356.7 million at September 30, 2005, from \$440.3 million at December 31, 2004, primarily due to maturing municipal, wholesale and brokered certificates of deposits totaling \$59.5 million that were not renewed. Core deposits (savings, money market, noninterest bearing demand and NOW accounts), represented 65.8% of total deposits at September 30, 2005, compared to 60.5% of total deposits at December 31, 2004.

Borrowings decreased \$83.5 million, or 31.5%, to \$181.3 million at September 30, 2005, from \$264.7 million at December 31, 2004, due to our use of a portion of the subscription offering proceeds to repay term debt and reduce Federal Home Loan Bank borrowings. We used \$30 million of the net proceeds of the subscription offering to repay the \$30 million in term debt that we incurred in acquiring Success Bancshares in 2001 and in redeeming trust preferred securities assumed in that acquisition. We used \$54.0 million of the net proceeds of the subscription offering to repay maturing Federal Home Loan Bank borrowings.

Total stockholders' equity increased \$230.1 million to \$325.0 million, compared to members' equity of \$94.9 million at

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December 31, 2004. The net proceeds of the subscription offering totaled \$240.3 million and are reflected as common stock and additional paid-in capital. Our ESOP borrowed \$19.6 million from the Company and used the proceeds of the loan to purchase 1,957,300 shares issued in the subscription offering. The ESOP's unallocated shares are reflected as a reduction to equity at September 30, 2005. Retained earnings increased \$8.2 million due to the Company's net income for the nine months ended September 30, 2005. Total stockholders' equity at September 30, 2005, reflected an unrealized loss on securities available for sale of \$332,000, net of tax, compared to an unrealized loss on securities available for sale of \$1.6 million, net of tax, at December 31, 2004.

Comparison of Operating Results for the Three Months Ended September 30, 2005 and September 30, 2004

Net Income. We had net income of \$3.7 million for the three months ended September 30, 2005, compared to a net loss of \$1.0 million for the three months ended September 30, 2004. The net loss in the third quarter of 2004 was primarily attributable to a \$5.5 million impairment loss, pre-tax, that we recorded for that period in connection with our holdings in a Freddie Mac floating rate preferred stock issue. Other factors impacting the increase in net income from year to year include a \$2.9 million, or 25.9%, increase in our net interest income, a \$546,000 increase in our provision for loan losses, and a \$1.1 million, or 17.2% increase in compensation and benefits expenses. Our basic and diluted earnings per share of common stock for the three months ended September 30, 2005, were \$0.16 per share.

Interest Income. Interest income increased \$4.0 million, or 23.9%, to \$20.7 million for the three months ended September 30, 2005, from \$16.7 million for the three months ended September 30, 2004. The increase in interest income reflected a 63 basis point improvement in the average yield on interest-earning assets to 5.45% from 4.82%, and a \$133.9 million, or 9.7%, increase in total average interest-earning assets. The increase in average interest earning-assets reflected the investment of subscription order receipts and the subsequent investment of the net proceeds of the subscription offering.

Interest income from loans, the most significant portion of interest income, increased \$2.6 million, or 18.5%, to \$17.0 million for the three months ended September 30, 2005, from \$14.3 million for the same period in 2004. The increase reflected earnings on a \$35.4 million, or 3.2%, increase in the average balance of net loans receivable to \$1.130 billion for the three months ended September 30, 2005, from \$1.095 billion for the same period in 2004, and a 77 basis point increase in the average yield on loans to 6.00% for the three months ended September 30, 2005, from 5.23% for the three months ended September 30, 2004. The increase in interest income from loans was primarily due to increased interest income from construction, commercial and home equity loans, which are predominantly indexed to the prime rate. The yields on construction, commercial and home equity loans improved more than 150 basis points from the third quarter in 2004 to the third quarter in 2005 due to the increases in the prime rate that occurred during this period. The yields on non-residential real estate loan yields increased more moderately, and the yields on other loan categories increased only slightly, during the same period.

Interest income from securities available for sale increased \$1.2 million, or 58.8%, to \$3.2 million for the three months ended September 30, 2005, from \$2.0 million for the three months ended September 30, 2004. The average yield on securities available for sale increased 68 basis points to 3.83% from 3.15% due to rising interest rates, and the average outstanding balance of securities available for sale increased \$78.5 million, or 30.4%, to \$337.1 million due to the investment of subscription order receipts and the subsequent investment of the net proceeds of the subscription offering.

Interest income from interest bearing deposits and Federal Home Loan Bank of Chicago stock dividends totaled \$538,000 for the quarter ended September 30, 2005, compared to \$379,000 for the quarter ended September 30, 2004. The increase reflects a \$19.9 million increase in the average outstanding balance of the interest-bearing deposit accounts that we maintained in other institutions, from \$33.1 million for the third quarter of 2004, to \$53.1 million for the third quarter of 2005.

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Interest Expense. Interest expense increased \$1.1 million, or 20.1%, to \$6.8 million for the three months ended September 30, 2005, from \$5.7 million for the three months ended September 30, 2004. This increase reflected an increase in the weighted average interest rates that we paid on deposit accounts, and an increase in the average interest rates that we paid on our Federal Home Loan Bank borrowings. The increase in interest expense reflected an overall increase of 56 basis points in the cost of average interest-bearing liabilities, to 2.38% for the three months ended September 30, 2005, from 1.82% for the three months ended September 30, 2004.

Interest expense on deposits increased \$1.3 million, or 34.8%, to \$5.1 million for the three months ended September 30, 2005, from \$3.8 million for the same period in 2004. The increase reflected a 64 basis point increase in the average rate paid on deposits to 2.12% for the three months ended September 30, 2005, from 1.48% for the three months ended September 30, 2004. The increase in rates paid offset a \$58.9 million, or 5.8%, decrease in average interest-bearing deposits, to \$957.2 million for the three months ended September 30, 2005, from \$1.016 billion for the same period in 2004. Interest expense on deposits increased for all categories of interest bearing deposits principally due to increases in short-term market interest rates and the effect of those increases on the interest rates paid to depositors, and increased average balances for money market and NOW account deposits.

Interest expense on money market accounts increased \$791,000, or 100.5%, reflecting an increase of \$32.2 million in the average balance of money market account deposits to \$222.6 million for the three months ended September 30, 2005, from \$190.5 million for the three months ended September 30, 2004, and a 118 basis point increase in the interest rate paid on these accounts to 2.84% from 1.65%. We had \$169.3 million in indexed money market accounts at September 30, 2005. We increased the interest rates paid on money market accounts, certain NOW accounts and savings accounts beginning in the third quarter of 2004 due to changes in applicable indices and in response to increasing short-term market interest rates and anticipated increases in rates paid by our competitors. Rates on other selected money market products and certificates of deposit were also increased for competitive reasons.

Interest expense on certificates of deposit increased \$250,000, or 10.3%, reflecting an increase of 79 basis points to 2.89% for the three months ended September 30, 2005, from 2.10% for the same period in 2004. This increase was partially offset by a \$92.5 million decrease in the average balance of certificates of deposit to \$369.4 million for the three months ended September 30, 2005, from \$461.9 million for the three months ended September 30, 2004, due primarily to maturing municipal, wholesale and brokered certificates of deposit totaling \$22.0 million that were not renewed.

Interest expense on borrowings decreased by \$167,000, or 8.7%, to \$1.8 million for the three months ended September 30, 2005, from \$1.9 million for the same period in 2004. The decrease was primarily attributable to our use of a portion of the net proceeds of the subscription offering to retire term debt, and to lower yield adjustment amortization expense relating to our restructuring of \$170.0 million of Federal Home Loan Bank borrowings in July 2003. The yield adjustment amortization expense for the three months ended September 30, 2005, was \$39,000, pre-tax, compared to \$254,000, pre-tax, for the three months ended September 30, 2004. The amortization of the yield adjustment expense was completed in July 2005. We used \$30 million of the net proceeds of the subscription offering to repay the \$30 million in term debt that we incurred in acquiring Success Bancshares in 2001 and in redeeming trust preferred securities assumed in that acquisition. We thus had no interest expense on this term debt for the three months ended September 30, 2005, compared to \$277,000 in interest expense on this term debt for the same three month period in 2004.

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Average Balances

The following table reflects the average yield on assets and average cost of liabilities for the periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities. Average balances are derived from average daily balances. Loans receivable balances include non-accrual loans.

| | For the Three Months ended September 30, | | | | | |
|---|--|-----------------|----------------|-----------------------------|-----------------|----------------|
| | 2005 | | | 2004 | | |
| | Average Outstanding Balance | Interest | Yield/Rate (1) | Average Outstanding Balance | Interest | Yield/Rate (1) |
| Dollars in thousands | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans | \$1,130,131 | \$16,950 | 6.00% | \$1,094,700 | \$14,307 | 5.23% |
| Securities available-for-sale | 337,098 | 3,229 | 3.83 | 258,554 | 2,033 | 3.15 |
| Stock in FHLB | 25,043 | 308 | 4.92 | 23,694 | 348 | 5.87 |
| Other | 27,962 | 230 | 3.29 | 9,406 | 31 | 1.32 |
| Total interest-earning assets | 1,520,234 | 20,717 | 5.45 | 1,386,354 | 16,719 | 4.82 |
| Noninterest-earning assets | 87,043 | | | 85,875 | | |
| Total assets | \$1,607,277 | | | \$1,472,229 | | |
| Interest-bearing liabilities: | | | | | | |
| Savings deposits | \$ 125,949 | 249 | 0.79 | \$ 135,240 | 227 | 0.67 |
| Money market deposits | 222,645 | 1,578 | 2.84 | 190,475 | 787 | 1.65 |
| NOW deposits | 239,294 | 585 | 0.98 | 228,503 | 335 | 0.59 |
| Certificates of deposit | 369,352 | 2,672 | 2.89 | 461,889 | 2,422 | 2.10 |
| Total deposits | 957,240 | 5,084 | 2.12 | 1,016,107 | 3,771 | 1.48 |
| Borrowings | 191,076 | 1,755 | 3.67 | 236,192 | 1,922 | 3.25 |
| Total interest-bearing liabilities | 1,148,316 | 6,839 | 2.38 | 1,252,299 | 5,693 | 1.82 |
| Noninterest-bearing liabilities | 134,903 | | | 123,694 | | |
| Total liabilities | 1,283,219 | | | 1,375,993 | | |
| Equity | 323,058 | | | 96,236 | | |
| Total liabilities and equity | \$1,607,277 | | | \$1,472,229 | | |
| Net interest income | | \$13,878 | | | \$11,026 | |
| Net interest rate spread (1) | | | 3.07% | | | 3.00% |
| Net interest-earning assets (2) | \$ 371,918 | | | \$ 134,055 | | |
| Net interest margin (3) | | | 3.65% | | | 3.18% |
| Ratio of interest-earning assets to interest-bearing liabilities | 132.39% | | | 110.70% | | |

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

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

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

Net Interest Income. Net interest income increased by \$2.9 million, or 25.9%, to \$13.9 million for the three months ended September 30, 2005, from \$11.0 million for the three months ended September 30, 2004. The increase in net interest income reflected an improvement in our net interest rate spread to 3.07% for the three months ended September 30, 2005, from 3.00% for the three months ended September 30, 2004. Our net interest margin improved to 3.65% for the three months ended September 30, 2005, from 3.18% for the three months ended September 30, 2004. Net interest income for the three months ended September 30, 2005 included the impact of higher interest earning assets and lower interest-bearing liabilities due to subscription order receipts and net proceeds. The three months ended September 30, 2005, included approximately \$150,000 of net interest rate spread that we earned on \$167.1 million in subscription orders receipts that, at September 30, 2005, have been substantially refunded to subscribers.

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

Based on our evaluation of the above factors, we recorded a provision for loan losses of \$334,000 for the three months ended September 30, 2005, compared to a credit to our loan loss reserves of \$212,000 for the three months ended September 30, 2004. The allowance for performing loans increased \$216,000 for the three months ended September 30, 2005, due to growth in our loan portfolio. The allowance for impaired loans increased \$118,000, net of reductions of specific reserves, to \$1.8 million at September 30, 2005, compared to \$1.7 million at June 30, 2005. Non-performing loans increased \$407,000 to \$7.3 million at September 30, 2005, from \$6.9 million at June 30, 2005, primarily due to increased non-accrual one-to-four family residential mortgages.

During the three months ended September 30, 2005, we restructured two previously classified, non-performing commercial real estate loans totaling \$3.7 million. One loan involved a debtor that began operating under an agreed-upon Chapter 11 plan of reorganization, and the other involved an agreed-upon sale of healthcare-related real estate by the borrower to a new buyer, the facility operator, to which we provided financing. Although the two loans were current as to all scheduled payments as of September 30, 2005, the loans will remain on nonaccrual status until the borrowers achieve a sustained period of payment performance, and until then, all interest payments made on the two loans will be recorded on a cash basis as received. We increased the specific reserve on one of the loans due to provisions of the contract for the sale of the underlying property that required the application of a partial payment made by a guarantor to certain expenses. We also established specific reserves for four small business loans where the collateral consists of general business assets that we believe have a nominal liquidation value.

Reductions of specific reserves allocated to impaired loans totaled \$57,000 and were based on the receipt of supplemental collateral securing a certain classified loan. Because collateral for certain classified loans includes marketable securities, fluctuations in the allocated specific reserves attributable to these loans should be expected to occur in the future due to possible changes in the market value of these securities, and declines in market value could result in future provisions for additional specific reserves.

Our allowance for loan losses totaled \$10.9 million, or 0.96%, of total loans at September 30, 2005, compared to \$10.6 million, or 0.96%, of total loans at June 30, 2005. We used the same general methodology in evaluating the allowance for loan losses at both dates. Our allowance for loan losses represented 150.15% of non-performing loans at September 30, 2005, and 154.17% of non-performing loans at June 30, 2005.

Noninterest Income. Our noninterest income increased \$182,000, or 7.7%, to \$2.5 million for the three months ended September 30, 2005, compared to \$2.4 million for the same period in 2004. We had a \$189,000, or 13.2%, improvement in fee income, primarily due to increased fees and service charges relating to overdraft activity on deposit accounts. Income from insurance commissions and annuities increased by \$84,000, or 46.4%, to \$265,000 for the three months ended September 30, 2005, compared to \$181,000 for the same period in 2004. Gain on sales of loans decreased \$8,000, or 13.8%, to \$50,000 for the three months ended September 30, 2005, from \$58,000 for the same period in 2004. Current quarter loan sales reflect \$6.4 million of loan sale proceeds, compared to \$5.5 million for the three months ended September 30, 2004. Loan servicing fees decreased \$6,000, or 2.3%, to \$257,000 for the three months

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ended September 30, 2005, compared to \$263,000 for the same three-month period in 2004. Amortization of mortgage servicing rights increased \$47,000, or 29.1% to \$208,000 for the three months ended September 30, 2005, compared to \$161,000 for the same three-month period in 2004. For the three months ended September 30, 2005, we had a mortgage servicing rights valuation reserve recovery of \$135,000 due to rising medium-term interest rates and declining prepayment rates, compared to the \$46,000 mortgage servicing rights impairment charge that we recorded for the three months ended September 2004, due to the declining medium term interest rates and increasing prepayment rates that were occurring at that time. We had \$1,000 of net expenses from real estate owned operations for the three months ended September 30, 2005, compared to income from real estate owned operations of \$405,000 for the same period in 2004. Other income increased \$194,000, or 88.6%, to \$413,000 for the three months ended September 30, 2005. Other income for the three months ended September 30, 2005 included a \$4,000 pass-through gain, pre-tax, that we recorded on several Community Reinvestment Act investments in low and moderate income housing limited partnerships, compared to a \$225,000 pass-through loss, pre-tax, that we recorded on those investments for the same period of 2004.

Noninterest Expense. Our noninterest expense was \$11.4 million for the three months ended September 30, 2005, an improvement of \$4.2 million, or 27.0%, compared to noninterest expense of \$15.6 million for the three months ended September 30, 2004. Noninterest expense for the three months ended September 30, 2004, included a \$5.5 million impairment loss, pre-tax, that we recorded in connection with our holdings in a Freddie Mac floating rate preferred stock issue; we recorded no securities impairment losses for the three months ended September 30, 2005. Excluding the impact of the \$5.5 million impairment loss in 2004, the change in total noninterest expense for the three months ending September 30, 2005, compared to the same period in 2004 would have been an increase of \$1.3 million, or 12.7%. Total compensation and benefits expense totaled \$7.3 million for the three-month period ended September 30, 2005, compared to \$6.3 million in compensation and benefits expense for the same period in 2004, an increase of \$1.1 million, or 17.2%. The three-month period ended September 30, 2005, includes \$345,000 in expenses for our ESOP plan, and there were no such expenses for the same period in 2004 because we did not adopt our ESOP plan until June of 2005. Data processing expense increased \$145,000, or 22.9%, for the three months ended September 30, 2005 compared to the same period of 2004.

Income Tax Expense. We recorded income tax expense of \$990,000 for the three months ended September 30, 2005, compared to a tax benefit of \$969,000 for the three months ended September 30, 2004. Tax expense for the three months ended September 30, 2005 reflects a tax benefit of \$473,000, the majority of which relates to tax returns for which the statute of limitations had expired during the three months ended September 30, 2005. As a result of this tax benefit, our effective tax rate for the three-months ended September 30, 2005 was 21.1%.

Comparison of Operating Results for the Nine Months Ended September 30, 2005 and September 30, 2004

Net Income. We had net income of \$8.2 million for the nine months ended September 30, 2005, compared to net income of \$1.4 million for the nine months ended September 30, 2004. The increase in net income was primarily attributable to a \$6.1 million, or 19.4%, increase in our net interest income, which was partially offset by a \$1.3 million, or 6.9%, increase in compensation and benefits. Our net income for the nine months ended September 30, 2004 also reflected a \$5.5 million impairment loss, pre-tax, that we recorded in connection with our holdings in a Freddie Mac floating rate preferred stock issue.

Interest Income. Interest income increased \$10.1 million, or 20.8%, to \$58.8 million for the nine months ended September 30, 2005, from \$48.7 million for the nine months ended September 30, 2004. The increase in interest income reflected a 52 basis point improvement in the average yield on interest-earning assets to 5.24% from 4.72%, and a \$121.8 million, or 8.8%, increase in total average interest-earning

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assets. The increase in average interest earning assets reflected the investment of subscription order receipts and the subsequent investment of the net proceeds of the subscription offering. These short-term investments are reflected in the average balances of cash and cash equivalents and securities available for sale, and subscription order receipts are also reflected in the average balances of interest-bearing deposits and demand deposits during the nine-month period ended September 30, 2005.

Interest income from loans increased \$6.6 million, or 15.8%, to \$48.2 million for the nine months ended September 30, 2005, from \$41.6 million for the same period in 2004. The increase reflected a \$23.1 million, or 2.1%, increase in the average balance of net loans receivable to \$1.113 billion for the nine months ended September 30, 2005, from \$1.090 billion for the same period in 2004, and a 69 basis point increase in the average yield on loans to 5.78% for the nine months ended September 30, 2005, compared to 5.09% for the nine months ended September 30, 2004.

Interest income from securities available for sale increased \$3.1 million, or 52.1%, to \$9.0 million for the nine months ended September 30, 2005, compared to \$5.9 million for the nine months ended September 30, 2004. The average yield on securities available for sale increased 49 basis points to 3.61% from 3.12% due to rising interest rates, and the average outstanding balance of securities available for sale increased \$79.8 million, or 31.6%, to \$332.0 million for the nine months ended September 30, 2005, from \$252.2 million for the nine months ended September 30, 2004, due to the investment of subscription order receipts and net proceeds. The average outstanding balance of securities available for sale included the investment of subscription order receipts in short-term U.S. government agency notes.

Interest income from interest-bearing deposits and Federal Home Loan Bank of Chicago stock dividends totaled \$1.6 million for the nine months ended September 30, 2005, compared to \$1.1 million for the nine months ended September 30, 2004. The \$455,000 increase in interest income from interest bearing deposits reflected an \$18.9 million increase in the average outstanding balance of the interest bearing deposit accounts that we maintain with other institutions, to \$52.8 million for the first nine months of 2005, compared to \$33.9 million for the same period in 2004. The current-year average balance of interest-bearing deposits and related interest income includes subscription order receipts and net proceeds.

Interest Expense. Interest expense on average interest bearing liabilities increased \$4.0 million, or 23.2%, to \$21.3 million for the nine months ended September 30, 2005, from \$17.2 million for the nine months ended September 30, 2004. The increase in interest expense reflected an overall increase of 37 basis points in the cost of average interest-bearing liabilities, to 2.22% for the nine months ended September 30, 2005, from 1.85% for the nine months ended September 30, 2004. This increase reflected an increase in the weighted average interest rates that we paid on certain deposit accounts, which was offset by a decrease in the average interest rates that we paid on our Federal Home Loan Bank borrowings.

Interest expense on deposits increased \$4.8 million, or 48.0%, to \$14.7 million for the nine months ended September 30, 2005, from \$10.0 million for the same period in 2004. This increase reflected a \$48.0 million, or 4.8%, increase in average interest-bearing deposits to \$1.040 billion for the nine months ended September 30, 2005, from \$991.7 million for the same period in 2004, due primarily to the deposit of subscription order receipts into an interest bearing account with the Bank. The increase also reflected a 55 basis point increase in the average rate paid on deposits to 1.89% for the nine months ended September 30, 2005, from 1.34% for the nine months ended September 30, 2004. Average NOW account deposits of \$286.1 million for the nine months ended September 30, 2005 included subscription order receipts.

Interest expense on deposits increased for all categories of interest bearing deposits. Interest expense on money market accounts increased \$2.5 million, reflecting an increase of \$43.2 million in the average balance of money market accounts deposits to \$215.3 million for the nine months ended September 30, 2005, from \$172.1 million for the nine months ended September 30, 2004, and a 130 basis point increase in the interest rate paid on these accounts to 2.61% from 1.31%. Interest expense on certificates of deposit increased \$1.3 million, reflecting a 62 basis point increase in the interest rate paid

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on these accounts to 2.66% from 2.04%. This increase was partially offset by a \$43.2 million decrease in the average balance of certificates of deposit to \$406.4 million for the nine months ended September 30, 2005, from \$449.6 million for the nine months ended September 30, 2004, primarily due to maturing municipal, wholesale and brokered certificates of deposits that were not renewed.

Interest expense on borrowings decreased by \$776,000, or 10.7%, to \$6.5 million for the nine months ended September 30, 2005, from \$7.3 million for the same period in 2004. The decrease was primarily attributable to lower interest expense on term debt and lower yield adjustment amortization expense relating to our restructuring of \$170 million of Federal Home Loan Bank borrowings in July 2003. The yield adjustment amortization expense for the nine months ended September 30, 2005, was \$388,000, pre-tax, compared to \$2.3 million pre-tax, for the nine months ended September 30, 2004. The amortization of the yield adjustment expense was completed in July 2005. Average borrowings decreased \$18.1 million, or 7.1%, due in part to our use of \$30 million of the net proceeds of the subscription offering to repay the \$30 million in term debt that we incurred in acquiring Success Bancshares in 2001 and in redeeming trust preferred securities assumed in that acquisition. Interest expense on our term debt totaled \$703,000 for the nine months ended September 30, 2005, compared to \$752,000 in interest expense on term debt for the same period in 2004.

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Average Balances

The following table reflects the average yield on assets and average cost of liabilities for the periods indicated. Such yields and costs are derived by dividing income or expense by the average balance of assets or liabilities. Average balances are derived from average daily balances. Loans receivable balances include non-accrual loans.

| | For the Nine Months ended September 30, | | | | | |
|---|---|-----------------|----------------|-----------------------------|-----------------|----------------|
| | 2005 | | | 2004 | | |
| | Average Outstanding Balance | Interest | Yield/Rate (1) | Average Outstanding Balance | Interest | Yield/Rate (1) |
| Dollars in thousands | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans | \$1,113,067 | \$48,231 | 5.78% | \$1,090,006 | \$41,649 | 5.09% |
| Securities available-for-sale | 331,963 | 8,981 | 3.61 | 252,184 | 5,905 | 3.12 |
| Stock in FHLB | 24,721 | 972 | 5.24 | 23,343 | 1,065 | 6.08 |
| Other | 28,111 | 630 | 2.99 | 10,577 | 80 | 1.01 |
| Total interest-earning assets | 1,497,862 | 58,814 | 5.24 | 1,376,110 | 48,699 | 4.72 |
| Noninterest-earning assets | 88,912 | | | 86,432 | | |
| Total assets | \$1,586,774 | | | \$1,462,542 | | |
| Interest-bearing liabilities: | | | | | | |
| Savings deposits | \$ 131,729 | 766 | 0.78 | \$ 135,602 | 572 | 0.56 |
| Money market deposits | 215,342 | 4,222 | 2.61 | 172,135 | 1,687 | 1.31 |
| NOW deposits | 286,137 | 1,645 | 0.77 | 234,364 | 841 | 0.48 |
| Certificates of deposit | 406,434 | 8,115 | 2.66 | 449,584 | 6,865 | 2.04 |
| Total deposits | 1,039,642 | 14,748 | 1.89 | 991,685 | 9,965 | 1.34 |
| Borrowings | 236,186 | 6,502 | 3.67 | 254,293 | 7,278 | 3.82 |
| Total interest-bearing liabilities | 1,275,828 | 21,250 | 2.22 | 1,245,978 | 17,243 | 1.85 |
| Noninterest-bearing liabilities | 128,005 | | | 122,180 | | |
| Total liabilities | 1,403,833 | | | 1,368,158 | | |
| Equity | 182,941 | | | 94,384 | | |
| Total liabilities and equity | \$1,586,774 | | | \$1,462,542 | | |
| Net interest income | | \$37,564 | | | \$31,456 | |
| Net interest rate spread (1) | | | 3.02% | | | 2.87% |
| Net interest-earning assets (2) | \$ 222,034 | | | \$ 130,132 | | |
| Net interest margin (3) | | | 3.34% | | | 3.05% |
| Ratio of interest-earning assets to interest-bearing liabilities | 117.40% | | | 110.44% | | |

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

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

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

Net Interest Income. Net interest income increased by \$6.1 million, or 19.4%, to \$37.6 million for the nine months ended September 30, 2005, from \$31.5 million for the nine months ended September 30, 2004. The increase in net interest income reflected an improvement in our net interest rate spread to 3.02% for the nine months ended September 30, 2005, from 2.87% for the nine months ended September 30, 2004. Our net interest margin improved to 3.34% for the nine months ended September 30, 2005, from 3.05% for the nine months ended September 30, 2004. Net interest income for the nine months ended September 30, 2005, included interest that we earned on the investment of subscription order receipts and the subsequent investment of the net proceeds from the subscription offering. The nine months ended September 20, 2005 included approximately \$450,000 of net interest rate spread earned on \$167.1 million in subscription orders receipts that, at September 30, 2005, had been substantially refunded to subscribers.

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Provision for Loan Losses We recorded a credit for loan losses of \$6,000 for the nine months ended September 30, 2005, compared to a credit for loan losses of \$212,000 for the nine months ended September 30, 2004. The allowance for performing loans increased \$245,000 for the nine months ended September 30, 2005, due to growth in our loan portfolio. The allowance for impaired loans decreased \$250,000, net of reductions, to \$1.8 million at September 30, 2005, compared to \$2.1 million at December 31, 2004.

Non-performing loans increased \$756,000 to \$7.3 million at September 30, 2005, from \$6.5 million at December 31, 2004. The most notable addition to non-performing loans was a \$2.0 million loan secured by real estate that was leased to the operator of a healthcare facility. The borrower sold the healthcare related real estate during the current year to the operator of the facility. We provided financing to the operator to acquire the real estate in 2005, and the prior loan was paid in full with the proceeds of the new loan. Non-performing multi-family and commercial loans decreased a combined \$854,000.

During the three months ended September 30, 2005, we restructured two (previously classified) non-performing commercial real estate loans totaling \$3.7 million. One loan involved a debtor that began operating under an agreed-upon Chapter 11 plan of reorganization, and the other involved an agreed-upon sale of healthcare-related real estate discussed above. Although the two loans were current as to all scheduled payments as of September 30, 2005, the loans will remain on nonaccrual status until the borrowers achieve a sustained period of payment performance, and until then, all interest payments made on the two loans will be recorded on a cash basis as received. We increased the specific reserve on one of the loans due to provisions of the contract for the sale of the underlying property that required the application of a partial payment made by a guarantor for payment to certain expenses. We also established specific reserves for four small business loans where the collateral consists of general business assets we believe have a nominal liquidation value.

Reductions of specific reserves allocated to impaired loans totaled \$418,000 due to the full repayment of two loans, principal reductions on several loans, increases in the value of existing collateral and the receipt of supplemental collateral securing certain other classified loans. Because collateral for certain classified loans includes marketable securities, fluctuations in the allocated specific reserves attributable to these loans should be expected to occur in the future due to possible changes in the market value of these securities, and declines in market value could result in future provisions for additional specific reserves.

Our allowance for loan losses totaled \$10.9 million, or 0.96%, of total loans at September 30, 2005, compared to \$11.0 million, or 1.00%, of total loans at December 31, 2004. We used the same general methodology in evaluating the allowance at both dates. Our allowance for loan losses represented 150.15% of our non-performing loans at September 30, 2005, and 168.90% of our non-performing loans at December 31, 2004.

Noninterest Income. Our noninterest income decreased \$243,000, 3.6%, to \$6.4 million for the nine months ended September 30, 2005, compared to \$6.7 million for the same period in 2004. We had a \$381,000, or 9.5%, improvement in fee income from \$4.0 million for the nine months ended September 30, 2004, to \$4.4 million for the nine months of 2005, primarily due to increased fees and service charges relating to overdraft activity on deposit accounts. Income from insurance commissions and annuities increased by \$45,000, or 8.0%, to \$606,000 for the nine months ended September 30, 2005, compared to \$561,000 for the same period in 2004. Gain on sales of loans decreased \$37,000, or 17.1%, to \$179,000 for the nine months ended September 30, 2005, from \$216,000 for the same period in 2004. Loan sale activity for the nine months ended September 30, 2005, reflected \$18.8 million of loan sale proceeds, compared to \$39.7 million of loan sale proceeds for the nine months ended September 30, 2004. We had no gains on the sale of securities for the first nine months of 2005, compared to a gain of \$419,000 for the same period in 2004.

Loan servicing fees increased \$60,000, or 8.3%, to \$782,000 for the nine months ended September 30, 2005, compared to \$722,000 for the same nine-month period in 2004. Amortization of mortgage servicing rights decreased \$133,000, or 19.7%, to \$544,000 for the nine months ended

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September 30, 2005, compared to \$677,000 for the same nine-month period in 2004. For the nine months ended September 30, 2005, we had a mortgage servicing rights valuation reserve recovery of \$17,000, compared to a recovery of \$162,000 for the same nine-month period in 2004. We had \$4,000 of income from real estate owned operations for the nine months ended September 30, 2005, compared to \$487,000 for the same period in 2004. Other income increased \$221,000, or 29.0%, to \$983,000 for the nine months ended September 30, 2005, compared to \$762,000 for the same period in 2004. Other income for the nine months ended September 30, 2005 reflected an \$86,000 pass-through loss, pre-tax, that we recorded on several Community Reinvestment Act investments in low and moderate income housing limited partnerships, compared to a \$329,000 pass-through loss, pre-tax, that we recorded on those investments for the same period of 2004.

Noninterest Expense. Our noninterest expense was \$32.7 million for the nine months ended September 30, 2005, an improvement of \$4.3 million, or 11.6%, compared to noninterest expense of \$37.0 million for the nine months ended September 30, 2004. Noninterest expense for the nine months ended September 30, 2004, included a \$5.5 million impairment loss, pre-tax, that we recorded in connection with our holdings in a Freddie Mac floating rate preferred stock issue. We recorded no securities impairment losses for the nine months ended September 30, 2005. Excluding the impact of the \$5.5 million impairment loss in 2004, the change in total noninterest expense for the nine months of 2005 compared to the nine months of 2004 would have been an increase of \$1.2 million, or 3.9%. Total compensation and benefits expense totaled \$20.8 million for the nine-month period ended September 30, 2005, compared to \$19.5 million in compensation and benefits expense for the same period in 2004 – an increase of \$1.3 million, or 6.9%. Compensation and benefits expense for the 2005 period includes \$370,000 for the establishment of our ESOP plan, an expense that did not exist prior to our mutual-to-stock conversion in June of 2005. Office occupancy and equipment expense decreased by \$125,000, or 3.3%, to \$3.7 million for the nine months of 2005, compared to \$3.8 million for the same period in 2004. Data processing expense increased \$106,000, or 5.2%, to \$2.2 million for the nine months ended September 30, 2005 compared to \$2.0 million for the same period in 2004. The nine-month period ended September 30, 2005 includes \$205,000 in expenses paid to an outside consultant for a Sarbanes-Oxley compliant internal controls review, and there were no such expenses for the same period in 2004.

Income Tax Expense. We recorded income tax expense of \$3.1 million for the nine months ended September 30, 2005, compared to a tax benefit of \$7,000 for the nine months ended September 30, 2004. Tax expense for the nine months ended September 30, 2005 reflects a tax benefit of \$473,000, the majority of which relates to tax returns for which statute of limitations had expired during the nine months ended September 30, 2005. As a result of this tax benefit, the effective tax rate for the nine-month period ended September 30, 2005 was 27.8%.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Quantitative Analysis. The principal market risk affecting the Company is interest rate risk. Interest rate risk is defined as the sensitivity of earnings and net asset values to changes in interest rates. As part of our efforts to monitor and manage interest rate risk, we use the “net portfolio value” (NPV) methodology and an internally prepared model to project and quantify interest rate risk. Generally, NPV is the discounted present value of the difference between cash flows on interest-rate sensitive assets and interest-rate sensitive liabilities. The application of this methodology attempts to quantify interest rate risk by projecting the change in NPV and net interest income that would result from various levels of theoretical changes in market interest rates.

The table below sets forth, as of September 30, 2005, the estimated changes in the Bank’s NPV and net interest income that would result from the designated instantaneous changes 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 attrition, and should not be relied upon as indicative of actual results. Given the historically low level of market interest rates, we did not estimate changes in NPV or net interest income for an interest rate decrease of greater than 200 basis points.

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| Change in Interest Rates (basis points) | NPV | | | Net Interest Income | | |
|---|---------------|--------------------------------------|---------|-------------------------------|--|---------|
| | Estimated NPV | Estimated Increase (Decrease) in NPV | | Estimated Net Interest Income | Increase (Decrease) in Estimated Net Interest Income | |
| | | Amount | Percent | | Amount | Percent |
| | | (Dollars in thousands) | | | | |
| +300 | \$265,192 | \$(2,372) | (0.9)% | \$ 55,923 | \$ 2,116 | 3.9% |
| +200 | 267,381 | (183) | (0.1) | 55,374 | 1,567 | 2.9 |
| +100 | 268,994 | 1,430 | 0.5 | 54,739 | 932 | 1.7 |
| 0 | 267,564 | — | — | 53,807 | — | — |
| -100 | 269,967 | 2,403 | 0.9 | 52,291 | (1,516) | (2.8) |
| -200 | 266,065 | (1,499) | (0.6) | 50,609 | (3,198) | (5.9) |

The table presented above projects that, at September 30, 2005, we would be expected to experience a 0.9% increase in NPV and a \$1.5 million decrease in net interest income in the event of an immediate and parallel 100 basis point decrease in interest rates. In the event of an immediate and parallel 200 basis point increase in interest rates, we would be expected to experience a 0.1% decrease in NPV and a \$1.6 million increase in net interest income.

Certain shortcomings are inherent in the methodology used in the above table and interest rate risk measurements. Modeling changes in NPV and net interest income require 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 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 table does not reflect the transitory impact of any actions that we may undertake in response to changes in interest rates, such as changes in the rates paid on certain deposit accounts due to local competitive factors, which would change the actual impact on NPV and net interest income. The table also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or the repricing characteristics of specific assets and liabilities. Accordingly, although the 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. The table also reflects the transitory impact of refundable subscription order receipts.

ITEM 4. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chairman and Chief Executive Officer and the 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, 2005. Based on that evaluation, the Company's management, including the Chairman, President and Chief Executive Officer and the Executive Vice President and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective. That evaluation did not identify any changes in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

There are no material pending legal proceedings to which the Company is a party other than ordinary course, routine litigation incidental to their respective businesses.

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

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

The exhibits required by Item 601 of Regulation S-K are included with this Form 10-Q and are listed on the “Index to Exhibits” immediately following the Signatures.

SIGNATURES

Pursuant to the requirements 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

(Registrant)

Date: November 14, 2005

/s/ F. Morgan Gasior

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

/s/ Paul A. Cloutier

Paul A. Cloutier
Executive Vice President and Chief Financial
Officer (Principal Financial Accounting Officer)

INDEX TO EXHIBITS

| <u>Exhibit Number</u> | <u>Description</u> |
|---------------------------|--|
| 31.1 | Certification of F. Morgan Gasior, Chairman of the Board, Chief Executive Officer and President, Pursuant to Rule 13a-14(a) and Rule 15d-14(a). |
| 31.2 | Certification of Paul A. Cloutier, Executive Vice President and Chief Financial Officer, Pursuant to Rule 13a-14(a) and Rule 15d-14(a). |
| 32.1 | Certification of F. Morgan Gasior, Chairman of the Board, Chief Executive Officer and President, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Paul A. Cloutier, Executive Vice President and Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

CERTIFICATION

I, F. Morgan Gasior, certify that:

- 1) I have reviewed this report on Form 10-Q of BankFinancial Corporation;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2005

/s/ F. Morgan Gasior

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

CERTIFICATION

I, Paul A. Cloutier, certify that:

- 1) I have reviewed this report on Form 10-Q of BankFinancial Corporation;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 14, 2005

/s/ Paul A. Cloutier

Paul A. Cloutier
Executive Vice President and Chief Financial
Officer (Principal Financial Accounting Officer)

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of BankFinancial Corporation (the "Company") on Form 10-Q for the period ending September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, F. Morgan Gasior, Chairman of the Board, Chief Executive Officer and President (Principal Executive Officer) of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ F. Morgan Gasior

Dated: November 14, 2005

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

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

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of BankFinancial Corporation (the "Company") on Form 10-Q for the period ending September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Paul A. Cloutier, Executive Vice President and Chief Financial Officer (Principal Financial Accounting Officer) of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Paul A. Cloutier

Dated: November 14, 2005

Paul A. Cloutier
Executive Vice President and Chief Financial
Officer (Principal Financial Accounting Officer)

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