

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2013

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

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

**BANKFINANCIAL CORPORATION**

(Exact Name of Registrant as Specified in Charter)

Maryland  
(State or Other Jurisdiction  
of Incorporation)

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

15W060 North Frontage Road, Burr Ridge, Illinois 60527

(Address of Principal Executive Offices)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class:	Name of Each Exchange on Which Registered:
Common Stock, par value \$0.01 per share	NASDAQ Global Select Stock Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the issuer is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

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

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

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

The aggregate market value of the registrant's outstanding voting common stock held by non-affiliates on June 30, 2013, determined using a per share closing price on that date of \$8.50, as quoted on The Nasdaq Stock Market, was \$168.2 million.

At March 11, 2014, there were 21,101,966 shares of common stock, \$0.01 par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

# BANKFINANCIAL CORPORATION

Form 10-K Annual Report

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## PART I

### **ITEM 1. BUSINESS**

#### **Forward Looking Statements**

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

Factors that could cause actual results to differ materially from the results anticipated or projected and which could materially and adversely affect our operating results, financial condition or future prospects include, but are not limited to: (i) less than anticipated loan growth due to intense competition for high quality loans and leases, particularly in terms of pricing and credit underwriting, or a dearth of borrowers who meet our underwriting standards; (ii) the impact of re-pricing and competitors’ pricing initiatives on loan and deposit products; (iii) adverse economic conditions in general and in the Chicago metropolitan area in particular, including high or increasing unemployment levels, that could result in increased delinquencies in our loan portfolio or a decline in the value of our investment securities and the collateral for our loans; (iv) declines in real estate values that adversely impact the value of our loan collateral, Other Real Estate Owned (“OREO”), asset dispositions and the level of borrower equity in their investments; (v) borrowers that experience legal or financial difficulties that we do not currently foresee; (vi) results of supervisory monitoring or examinations by regulatory authorities, including the possibility that a regulatory authority could, among other things, require us to increase our allowance for loan losses or adversely change our loan classifications, write-down assets, reduce credit concentrations or maintain specific capital levels; (vii) interest rate movements and their impact on the economy, customer behavior and our net interest margin; (viii) changes, disruptions or illiquidity in national or global financial markets; (ix) the credit risks of lending activities, including risks that could cause changes in the level and direction of loan delinquencies and charge-offs or changes in estimates relating to the computation of our allowance for loan losses; (x) monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board; (xi) factors affecting our ability to access deposits or cost-effective funding, and the impact of competitors’ pricing initiatives on our deposit products; (xii) the impact of new legislation or regulatory changes, including the Dodd-Frank Act and Basel III, on our products, services, operations and operating expenses; (xiii) higher federal deposit insurance premiums; (xiv) higher than expected overhead, infrastructure and compliance costs; (xv) changes in accounting principles, policies or guidelines; and (xvi) and our failure to achieve expected synergies and cost savings from acquisitions.

These risks and uncertainties, as well as the Risk Factors set forth in Item 1A below, should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. Forward looking statements speak only as of the date they are made. We do not undertake any obligation to update any forward-looking statement in the future, or to reflect circumstances and events that occur after the date on which the forward-looking statement was made.

#### **BankFinancial Corporation**

BankFinancial Corporation, a Maryland corporation headquartered in Burr Ridge, Illinois (the “Company”), became the owner of all of the issued and outstanding capital stock of BankFinancial, F.S.B. (the “Bank”) on June 23, 2005, when we consummated a plan of conversion and reorganization that the Bank and its predecessor holding companies, BankFinancial MHC, Inc. and BankFinancial Corporation, a federal corporation, adopted on August 25, 2004. BankFinancial Corporation, the Maryland corporation, was organized in 2004 to facilitate the mutual-to-stock conversion and to become the holding company for the Bank upon its completion.

As part of the mutual-to-stock conversion, BankFinancial Corporation, the Maryland corporation, sold 24,466,250 shares of common stock in a subscription offering for \$10.00 per share. The separate corporate existences of BankFinancial MHC and BankFinancial Corporation, the federal corporation, ceased upon the completion of the mutual-to-stock conversion. For a further discussion of the mutual-to-stock conversion, see our Prospectus as filed on April 29, 2005 with the Securities and Exchange

Commission (“SEC”) pursuant to Rule 424(b)(3) of the Rules and Regulations of the Securities Act of 1933 (File Number 333-119217).

We manage our operations as one unit, and thus do not have separate operating segments. Our chief operating decision-makers use consolidated results to make operating and strategic decisions.

### **BankFinancial, F.S.B.**

The Bank is a full-service, community-oriented federal savings bank principally engaged in the business of commercial, family and personal banking, and it offers our customers a broad range of loan, deposit, and other financial products and services through 20 full-service Illinois based banking offices located in Cook, DuPage, Lake and Will Counties, and through our Internet Branch, [www.bankfinancial.com](http://www.bankfinancial.com). The Bank’s Hyde Park East branch was closed effective January 2, 2014, reducing the total number of full-service banking offices to 19 as of that date.

The Bank’s primary business is making loans and accepting deposits. The Bank also offers our customers a variety of financial products and services that are related or ancillary to loans and deposits, including cash management, funds transfers, bill payment and other online banking transactions, automated teller machines, safe deposit boxes, trust services, wealth management, and general insurance agency services.

The Bank’s primary lending area consists of the counties where our branch offices are located, and contiguous counties in the State of Illinois. We derive the most significant portion of our revenues from these geographic areas. Through our Wholesale Commercial Lending and National Commercial Leasing Departments, we also engage in multi-family lending activities in selected metropolitan areas outside our primary lending area and in commercial leasing activities on a nationwide basis.

We originate deposits predominantly from the areas where our branch offices are located. We rely on our favorable locations, customer service, competitive pricing, our Internet Branch and related deposit services such as cash management to attract and retain these deposits. While we accept certificates of deposit in excess of the Federal Deposit Insurance Corporation (“FDIC”) deposit insurance limits, we generally do not solicit such deposits because they are more difficult to retain than core deposits and at times are more costly than wholesale deposits.

### **Lending Activities**

Our loan portfolio consists primarily of investment and business loans (multi-family, nonresidential real estate, commercial, construction and land loans, and commercial leases), which represented 81.7% of our gross loan portfolio of \$1.111 billion at December 31, 2013. At December 31, 2013, \$396.1 million, or 35.6%, of our total loan portfolio consisted of multi-family mortgage loans; \$263.6 million, or 23.7%, of our total loan portfolio consisted of nonresidential real estate loans; \$54.3 million, or 4.9%, of our total loan portfolio consisted of commercial loans; \$187.1 million, or 16.8%, of our total loan portfolio consisted of commercial leases; and \$6.6 million, or 0.6%, of our total loan portfolio consisted of construction and land loans. \$201.4 million, or 18.1%, of our total loan portfolio consisted of one-to-four family residential mortgage loans (of which \$54.9 million, or 4.9%, were loans to investors in non-owner occupied single-family homes), including home equity loans and lines of credit.

### **Deposit Activities**

Our deposit accounts consist principally of savings accounts, NOW accounts, checking accounts, money market accounts, certificates of deposit, and IRAs and other retirement accounts. We provide commercial checking accounts and related services such as cash management. We also provide low-cost checking account services. We rely on our favorable locations, customer service, competitive pricing, our Internet Branch and related deposit services such as cash management to attract and retain deposit accounts.

At December 31, 2013, our deposits totaled \$1.253 billion. Interest-bearing deposits totaled \$1.126 billion and noninterest-bearing demand deposits totaled \$126.7 million, which included \$3.1 million in internal checking accounts such as bank cashier’s checks and money orders. Savings, money market and NOW account deposits totaled \$850.4 million, and certificates of deposit totaled \$275.6 million, of which \$203.4 million had maturities of one year or less.

### **Related Products and Services**

The Bank provides trust and financial planning services through our Trust Department. The Bank’s Wealth Management Group provides investment, financial planning and other wealth management services to our customers through arrangements with a third-party broker-dealer. The Bank’s wholly-owned subsidiary, Financial Assurance Services, Inc. (“Financial Assurance”), sells property and casualty insurance and other insurance products on an agency basis. During the year ended December 31, 2013, Financial Assurance reported net income of \$68,000. At December 31, 2013, Financial Assurance had two full-time employees.

The Bank's other wholly-owned subsidiary, BF Asset Recovery Corporation, is in the business of holding title to and selling certain Bank-owned real estate acquired through collection action, and reported a loss of \$1,000 for the year ended December 31, 2013.

### **Website and Stockholder Information**

The website for the Company and the Bank is [www.bankfinancial.com](http://www.bankfinancial.com). Information on this website does not constitute part of this Annual Report on Form 10-K.

The Company makes available, free of charge, its Annual Report on Form 10-K, its Quarterly Reports on Form 10-Q, its Current Reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), as soon as reasonably practicable after such forms are filed with or furnished to the SEC. Copies of these documents are available to stockholders at BankFinancial's web site, [www.bankfinancial.com](http://www.bankfinancial.com), under Stockholder Information, and at the SEC's web site, [www.sec.gov](http://www.sec.gov).

### **Competition**

We face significant competition in originating loans and attracting deposits. The Chicago Metropolitan Area and some other areas in which we operate have a high concentration of financial institutions, many of which are significantly larger institutions that have greater financial resources than we have, and many of which are our competitors to varying degrees. Our competition for loans and leases comes principally from commercial banks, savings banks, mortgage banking companies, the U.S. Government, credit unions, leasing companies, insurance companies, real estate conduits and other companies that provide financial services to businesses and individuals. Our most direct competition for deposits has historically come from commercial banks, savings banks and credit unions. We face additional competition for deposits from online financial institutions and non-depository competitors such as the mutual fund industry, securities and brokerage firms and insurance companies.

We seek to meet this competition by emphasizing personalized service and efficient decision-making tailored to individual needs. In addition, we reward long-standing relationships with preferred rates and terms on deposit products based on existing and prospective lending business. We do not rely on any individual, group or entity for a material portion of our loans or our deposits.

### **Employees**

At December 31, 2013, we had 281 full-time employees and 39 part-time employees. The employees are not represented by a collective bargaining unit and we consider our working relationship with our employees to be good.

### **Supervision and Regulation**

#### **General**

As a federally chartered savings bank, the Bank is regulated and supervised primarily by the Office of the Comptroller of the Currency ("OCC"). The Bank is also subject to regulation by the FDIC in more limited circumstances because the Bank's deposits are insured by the FDIC. This regulatory and supervisory structure establishes a comprehensive framework of activities in which a financial institution may engage, and is intended primarily for the protection of the FDIC's deposit insurance fund, depositors and the banking system. Under this system of federal regulation, financial institutions are periodically examined to ensure that they satisfy applicable standards with respect to their capital adequacy, assets, management, earnings, liquidity and sensitivity to market interest rates. The OCC examines the Bank and prepares reports for the consideration of its Board of Directors on any identified deficiencies. After completing an examination, the OCC issues a report of examination and assigns a rating (known as an institution's CAMELS rating). Under federal law and regulations, an institution may not disclose the contents of its reports of examination or its CAMELS ratings to the public.

The Bank is a member of, and owns stock in, the Federal Home Loan Bank of Chicago ("FHLBC"), which is one of the 12 regional banks in the Federal Home Loan Bank System. The Bank also is regulated by the Board of Governors of the Federal Reserve System ("FRB") with regard to reserves it must maintain against deposits, dividends and other matters. The Bank's relationship with its depositors and borrowers also is regulated in some respects by both federal and state laws, especially in matters concerning the ownership of deposit accounts, and the form and content of the Bank's consumer loan documents.

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), which was signed by the President on July 21, 2010, provided for the transfer of the authority for regulating and supervising federal savings banks from the Office of Thrift Supervision ("OTS"), the Bank's previous regulator, to the OCC. The Dodd-Frank Act also provided for the transfer of authority for regulating and supervising savings and loan holding companies and their non-depository subsidiaries from the OTS to the FRB. The transfers occurred on July 21, 2011. The Dodd-Frank Act also created a new federal agency, the Consumer Financial Protection Bureau ("CFPB"), as an independent bureau within the FRB system, to conduct rule-making, supervision, and enforcement of federal consumer financial protection and fair lending laws and regulations. The CFPB has examination and primary

enforcement authority in connection with these laws and regulations for depository institutions with total assets of more than \$10 billion. Depository institutions with \$10 billion or less in total assets, such as the Bank, continue to be examined for compliance with these laws and regulations by their primary federal regulators, and remain subject to their enforcement authority.

The Dodd-Frank Act also broadened the base for FDIC assessments for deposit insurance and permanently increased the maximum amount of deposit insurance to \$250,000 per depositor. The Dodd-Frank Act increased shareholder influence over boards of directors by requiring companies to give shareholders a non-binding vote on executive compensation and so-called “golden parachute” payments. The legislation directed the FRB to promulgate rules prohibiting excessive compensation paid to company executives, regardless of whether the company is publicly traded. The Dodd-Frank Act also provided for originators of certain securitized loans to retain a percentage of the risk for transferred credits, directed the FRB to regulate pricing of certain debit card interchange fees, repealed restrictions on paying interest on checking accounts and contained a number of reforms related to mortgage origination.

There can be no assurance that laws, rules and regulations, and regulatory policies will not change in the future, which could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition, results of operations or prospects. Any change in these laws or regulations, or in regulatory policy, whether by the OCC, the FDIC, the FRB, the CFPB or Congress, could have a material adverse impact on the Company, the Bank and their respective operations. The following summary of laws and regulations applicable to the Bank and Company is not intended to be exhaustive and is qualified in its entirety by reference to the actual laws and regulations involved.

## **Federal Banking Regulation**

**Business Activities.** As a federal savings bank, the Bank derives its lending and investment powers from the Home Owners’ Loan Act, as amended, and the regulations, pronouncements or guidance of the OCC. Under these laws and regulations, the Bank may invest in mortgage loans secured by residential and nonresidential real estate, commercial business and consumer loans, certain types of securities and certain other loans and assets. Specifically, the Bank may originate, invest in, sell, or purchase unlimited loans on the security of residential real estate, while loans on nonresidential real estate generally may not, on a combined basis, exceed 400% of the Bank’s total capital. In addition, secured and unsecured commercial loans and certain types of commercial personal property leases may not exceed 20% of the Bank’s assets; however, amounts in excess of 10% of assets may only be used for small business loans. Further, the Bank may generally invest up to 35% of its assets in consumer loans, corporate debt securities and commercial paper on a combined basis, and up to the greater of its capital or 5% of its assets in unsecured construction loans. The Bank may invest up to 10% of its assets in tangible personal property, for rental or sale. Certain leases on tangible personal property are not aggregated with commercial or consumer loans for the purposes of determining compliance with the limitations set forth for those investment categories. The Bank also may establish subsidiaries that may engage in activities not otherwise permissible for the Bank directly, including real estate investment and insurance agency activities. A violation of the lending and investment limitations may be subject to the same enforcement mechanisms of the primary federal regulator as other violations of a law or regulation.

**Capital Requirements.** Federal regulations require federal savings banks to meet three minimum capital standards: a ratio of tangible capital to adjusted total assets of 1.5%; a ratio of Tier 1 (core) capital to adjusted total assets of 4.0% (3% for institutions receiving the highest rating on the CAMELS rating system); and a ratio of total capital to total risk-adjusted assets of 8.0%. The prompt corrective action standards discussed below, in effect, establish a minimum 2% tangible capital standard. The OCC is also authorized to establish individual minimum capital requirements for federal savings banks in excess of the above minimum capital standards.

The risk-based capital standard for federal savings banks requires the maintenance of Tier 1, or core capital, and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100%, assigned by the capital regulations based on the risks inherent in the type of asset. Core capital is defined as common stockholders’ equity (including retained earnings), certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries, less intangibles other than certain mortgage servicing rights and credit card relationships. The components of supplementary capital currently include cumulative perpetual preferred stock, long-term preferred stock, mandatory convertible securities, subordinated debt and intermediate-term preferred stock, allowance for loan and lease losses up to a maximum of 1.25% of risk-weighted assets and up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital. Additionally, a savings bank that retains credit risk in connection with an asset sale may be required to maintain additional regulatory capital because of the recourse back to the savings bank.

At December 31, 2013, the Bank’s capital exceeded all applicable regulatory requirements and was well capitalized.

**Final Capital Regulations.** In July 2013, the FDIC and the other federal bank regulatory agencies issued a final rule that will revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain “available-for-sale” securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt-in or opt-out is exercised. The rule limits a banking organization’s capital distributions and certain discretionary bonus payments to executive officers if the banking organization does not hold a “capital conservation buffer” consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule also implements the Dodd-Frank Act’s directive to apply to savings and loan holding companies consolidated capital requirements that are not less stringent than those applicable to their subsidiary institutions. The final rule is effective January 1, 2015. The “capital conservation buffer” will be phased in from January 1, 2016 to January 1, 2019, when the full capital conservation buffer will be effective.

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

**Loans-to-One-Borrower.** A federal savings bank generally may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus. An additional amount may be loaned, equal to 10% of unimpaired capital and surplus, if the loan is secured by readily marketable collateral, which generally does not include real estate. As of December 31, 2013, the Bank was in compliance with the loans-to-one-borrower limitations.

**Qualified Thrift Lender Test.** As a federal savings bank, the Bank is subject to a qualified thrift lender (“QTL”) test. Under the QTL test, the Bank must maintain at least 65% of its “portfolio assets” in “qualified thrift investments” in at least nine months of the most recent 12-month period. “Portfolio assets” generally means the total assets of a savings institution, less the sum of specified liquid assets up to 20% of total assets, goodwill and other intangible assets, and the value of property used in the conduct of the federal savings bank’s business.

“Qualified thrift investments” include various types of loans made for residential and housing purposes, investments related to those purposes, including certain mortgage-backed and related securities, and loans for personal, family, household and certain other purposes up to a limit of 20% of portfolio assets. “Qualified thrift investments” also include 100% of an institution’s credit card loans, education loans and small business loans. The Bank also may satisfy the QTL test by qualifying as a “domestic building and loan association” as defined in the Internal Revenue Code of 1986. At December 31, 2013, the Bank satisfied the QTL test. A federal savings bank that fails the QTL test must operate under specified restrictions, including limits on growth, branching, new investment and dividends. As a result of the Dodd-Frank Act, noncompliance with the QTL test is subject to regulatory enforcement action as a violation of law.

**Capital Distributions.** The regulations of the OCC govern capital distributions by a federal savings bank, which include cash dividends, stock repurchases and other transactions charged to the institution’s capital account. A federal savings bank must file an application for approval of a capital distribution if:

- the total capital distributions for the applicable calendar year exceed the sum of the institution’s net income for that year to date plus the federal savings bank’s retained net income for the preceding two years;
- the institution would not be at least adequately capitalized following the distribution;
- the distribution would violate any applicable statute, regulation, agreement or OCC-imposed condition; or
- the institution is not eligible for expedited treatment of its filings.

At December 31, 2013, the Bank would be required to file an application with the OCC for approval of a capital distribution to the Company. Whether or not an application to the OCC is required, every federal savings bank that is a subsidiary of a holding

company must file a notice with the FRB at least 30 days before the board of directors declares a dividend or approves a capital distribution.

The FRB may disapprove a notice or application if:

- the federal savings bank would be undercapitalized following the distribution;
- the proposed capital distribution raises safety and soundness concerns; or
- the capital distribution would violate a prohibition contained in any statute, regulation or agreement.

**Liquidity.** A federal savings bank is required to maintain a sufficient amount of liquid assets to ensure its safe and sound operation.

**Community Reinvestment Act and Fair Lending Laws.** All federal savings banks have a responsibility under the Community Reinvestment Act (“CRA”) and related federal regulations to help meet the credit needs of their communities, including low- and moderate- income neighborhoods. In connection with its examination of a federal savings bank, the OCC is required to evaluate and rate the federal savings bank’s record of compliance with the CRA. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices based on the characteristics specified in those statutes. A federal savings bank’s failure to comply with the provisions of the CRA could, at a minimum, result in regulatory restrictions on its activities. The failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions by the OCC, as well as other federal regulatory agencies and the Department of Justice. The Bank’s CRA performance has been rated as “Outstanding,” the highest possible rating, in all of the seven CRA Performance Evaluations that have been conducted since 1999.

**Privacy Standards.** Financial institutions are subject to regulations implementing the privacy protection provisions of the Gramm-Leach-Bliley Act. These regulations require the Bank to disclose its privacy policy, including identifying with whom it shares “nonpublic personal information” to customers at the time of establishing the customer relationship and annually thereafter. In addition, the Bank is required to provide its customers with the ability to “opt-out” of or consent to having the Bank share their nonpublic personal information with unaffiliated third parties before it can disclose such information, subject to certain exceptions. The implementation of these regulations did not have a material adverse effect on the Bank. The Gramm-Leach-Bliley Act also allows each state to enact legislation that is more protective of consumers’ personal information.

The OCC and other federal banking agencies have adopted guidelines establishing standards for safeguarding customer information to implement certain provisions of the Gramm-Leach-Bliley Act. The guidelines describe the agencies’ expectations for the creation, implementation and maintenance of an information security program, which would include administrative, technical and physical safeguards appropriate to the size and complexity of a financial institution and the nature and scope of its activities. The standards set forth in the guidelines are intended to ensure the security and confidentiality of customer records and information, to protect against any anticipated threats or hazards to the security or integrity of such records, and to protect against unauthorized access to or use of such records or other information that could result in substantial harm or inconvenience to any customer. The Bank has implemented these guidelines, and such implementation has not had a material adverse effect on our operations.

**Transactions with Related Parties.** A federal savings bank’s authority to engage in transactions with its “affiliates” is limited by OCC regulations and by Sections 23A and 23B of the Federal Reserve Act and its implementing regulation, Regulation W. The term “affiliates” for these purposes generally means any company that controls or is under common control with an insured depository institution, although subsidiaries of federal savings banks are generally not considered affiliates for the purposes of Sections 23A and 23B of the Federal Reserve Act. The Company is an affiliate of the Bank. In general, transactions with affiliates must be on terms that are as favorable to the federal savings bank as comparable transactions with non-affiliates. In addition, certain types of these transactions are restricted to an aggregate percentage of the federal savings bank’s capital. Collateral in specified amounts must usually be provided by affiliates in order to receive loans from the federal savings bank. Federal regulations also prohibit a federal savings bank from lending to any of its affiliates that are engaged in activities that are not permissible for bank holding companies, and from purchasing the securities of any affiliate, other than a subsidiary.

The Bank’s authority to extend credit to its directors, executive officers and 10% stockholders, as well as to entities controlled by such persons, is currently governed by the requirements of Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O of the Federal Reserve Board. Among other things, these provisions require that extensions of credit to insiders be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features, and not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Bank’s capital. In addition, extensions of credit in excess of certain limits must receive the prior approval of the Bank’s Board of Directors.



**Enforcement.** The OCC has primary enforcement responsibility over federal savings banks, and this includes the authority to bring enforcement action against the Bank and all “institution-affiliated parties,” including stockholders, attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an insured institution. Formal enforcement action may range from the issuance of a capital directive or cease and desist order to the removal of officers and/or directors, receivership, conservatorship or the termination of deposit insurance. Civil monetary penalties cover a wide range of violations and actions, and range up to \$25,000 per day, unless a finding of reckless disregard is made, in which case penalties may be as high as \$1 million per day. The FDIC also has the authority to recommend to the OCC that an enforcement action be taken with respect to a particular savings institution. If action is not taken by the OCC, the FDIC has authority to take action under specified circumstances.

**Standards for Safety and Soundness.** Federal law requires each federal banking agency to prescribe certain standards for all insured depository institutions. These standards relate to, among other things, internal controls, information systems and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, compensation and other operational and managerial standards as the agency deems appropriate. The federal banking agencies adopted Interagency Guidelines Prescribing Standards for Safety and Soundness to implement the safety and soundness standards required under federal law. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The guidelines address internal controls and information systems, internal audit systems, credit underwriting, loan documentation, interest rate risk exposure, asset growth, compensation, fees and benefits. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard.

**Prompt Corrective Action Regulations.** Under the prompt corrective action regulations, the OCC is required and authorized to take supervisory actions against undercapitalized federal savings banks. For this purpose, a federal savings bank is placed in one of the following five categories based on the federal savings bank’s capital:

- well-capitalized (at least 5% leverage capital, 6% tier 1 risk-based capital and 10% total risk-based capital);
- adequately capitalized (at least 4% leverage capital, 4% tier 1 risk-based capital and 8% total risk-based capital);
- undercapitalized (less than 3% leverage capital, 4% tier 1 risk-based capital or 8% total risk-based capital);
- significantly undercapitalized (less than 3% leverage capital, 3% tier 1 risk-based capital or 6% total risk-based capital); and
- critically undercapitalized (less than 2% tangible capital).

Generally, the banking regulator is required to appoint a receiver or conservator for a federal savings bank that is “critically undercapitalized.” The regulations also provide that a capital restoration plan must be filed with the OCC within 45 days of the date a bank receives notice that it is “undercapitalized,” “significantly undercapitalized” or “critically undercapitalized.” A parent holding company for the institution involved must guarantee performance under the capital restoration plan up to the lesser of the institution’s capital deficiency when deemed undercapitalized or 5% of the institution’s assets. In addition, numerous mandatory supervisory actions become immediately applicable to the federal savings bank, including, but not limited to, restrictions on growth, investment activities, capital distributions and affiliate transactions. The OCC may also take any one of a number of discretionary supervisory actions against undercapitalized federal savings banks, including the issuance of a capital directive and individual minimum capital requirements and the replacement of senior executive officers and directors.

At December 31, 2013, the Bank met the criteria for being considered “well-capitalized” as defined in the prompt corrective action regulations.

In connection with the final capital rule described earlier, the federal banking agencies have adopted revisions, effective January 1, 2015, to the prompt corrective action framework. Under the revised prompt corrective action requirements, insured depository institutions would be required to meet the following in order to qualify as “well capitalized:” (1) a common equity Tier 1 risk-based capital ratio of 6.5%; (2) a Tier 1 risk-based capital ratio of 8% (increased from 6%); (3) a total risk-based capital ratio of 10% (unchanged from current rules) and (4) a Tier 1 leverage ratio of 5% (unchanged from the current rules).

**Interest on Deposits.** Federal laws and regulations previously prohibited depository institutions from paying interest on commercial checking accounts. The Dodd-Frank Act authorized the payment of interest on commercial checking accounts, effective July 21, 2011.

**Insurance of Deposit Accounts.** The Bank’s deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC. Under the FDIC’s risk-based assessment system, insured institutions are assigned to one of four risk categories based on

supervisory evaluations, regulatory capital levels and certain other factors, with less risky institutions paying lower assessments. An institution's assessment rate depends upon the category to which it is assigned, subject to certain adjustments specified by the FDIC. The FDIC may adjust the scale uniformly, except that no adjustment may deviate by more than two basis points from the base scale without notice and comment. No institution may pay a dividend if it is in default of the federal deposit insurance assessment.

Assessment rates previously ranged from seven to 77.5 basis points of assessable deposits. The Dodd-Frank Act required the FDIC to revise its procedures to base its assessments upon total assets less tangible equity instead of on deposits. The FDIC issued a final rule, effective April 1, 2011, that implemented that change. The FDIC also revised the assessment schedule and certain of the possible adjustments so that the range of assessments is now 2.5 basis points to 45 basis points of total assets less tangible equity.

The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by September 30, 2020. Insured institutions with assets of \$10 billion or more are supposed to fund the increase. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving the ratio to the discretion of the FDIC. The FDIC recently exercised that discretion by establishing a long-range fund ratio of 2%.

The FDIC has authority to increase insurance assessments. A significant increase in insurance premiums would be likely have an adverse effect on the operating expenses and results of operations of the Bank. The Bank cannot predict what its insurance assessment rates will be in the future.

An insured institution's deposit insurance may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or regulatory condition imposed in writing. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

In addition to the FDIC assessments, the Financing Corporation ("FICO") is authorized to impose and collect, with the approval of the FDIC, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980's to recapitalize the former Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019.

**Prohibitions Against Tying Arrangements.** Federal savings banks are prohibited, subject to some exceptions, from extending credit to or offering any other service, or fixing or varying the consideration for such extension of credit or service, on the condition that the customer obtain some additional service from the institution or its affiliates or not obtain services of a competitor of the institution.

**Federal Home Loan Bank System.** The Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The Federal Home Loan Bank System provides a central credit facility primarily for member institutions. As a member of the FHLBC, the Bank is required to acquire and hold shares of capital stock in the FHLBC in specified amounts. As of December 31, 2013, the Bank was in compliance with this requirement.

#### **The USA PATRIOT Act and the Bank Secrecy Act**

The USA PATRIOT Act and the Bank Secrecy Act require financial institutions to develop programs to detect and report money-laundering and terrorist activities, as well as suspicious activities. The USA PATRIOT Act also gives the federal government powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. The federal banking agencies are required to take into consideration the effectiveness of controls designed to combat money-laundering activities in determining whether to approve a merger or other acquisition application of a member institution. Accordingly, if we engage in a merger or other acquisition, our controls designed to combat money laundering would be considered as part of the application process. In addition, non-compliance with these laws and regulations could result in fines, penalties and other enforcement measures. We have developed policies, procedures and systems designed to comply with these laws and regulations.

#### **Federal Reserve System**

The FRB's regulations require federal savings banks to maintain noninterest-earning reserves against their transaction accounts, such as negotiable order of withdrawal and regular checking accounts. At December 31, 2013, the Bank was in compliance with these reserve requirements. The balances maintained to meet the reserve requirements imposed by the FRB may be used to satisfy liquidity requirements imposed by the federal regulation.

## **Holding Company Regulation**

The Company is a unitary savings and loan holding company and is subject to regulation and supervision by the FRB. The FRB has enforcement authority over the Company and its non-savings institution subsidiaries. Among other things, this authority permits the FRB to restrict or prohibit activities that are determined to be a risk to the Bank. The Dodd-Frank Act provided for the transfer of the authority for supervising and regulating savings and loan holding companies and their non-depository subsidiaries from the OTS to the FRB. The transfer occurred on July 21, 2011.

The Company's activities are limited to the activities permissible for financial holding companies or for multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, including underwriting equity securities and insurance, incidental to financial activities or complementary to a financial activity. The Dodd-Frank Act specifies that a savings and loan holding company may only engage in financial holding company activities if it meets the qualitative criteria necessary for a bank holding company to engage in such activities. A multiple savings and loan holding company is generally limited to activities permissible for bank holding companies under Section 4(c) (8) of the Bank Holding Company Act, subject to the prior approval of the FRB, and certain additional activities authorized by FRB regulations.

Federal law prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from acquiring control of another savings institution or holding company thereof, without prior written approval of the FRB. It also prohibits the acquisition or retention of, with specified exceptions, more than 5% of the equity securities of a company engaged in activities that are not closely related to banking or financial in nature or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the FRB must consider the financial and managerial resources and future prospects of the savings institution, the effect of the acquisition on the risk to the insurance fund, the convenience and needs of the community and competitive factors.

**Capital.** Savings and loan holding companies are not currently subject to specific regulatory capital requirements. The Dodd-Frank Act, however, required the FRB to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to their subsidiary depository institutions. Instruments such as cumulative preferred stock and trust-preferred securities, which are currently includable within Tier 1 capital by bank holding companies within certain limits, would no longer be includable as Tier 1 capital, subject to certain grandfathering. The previously discussed final rule regarding regulatory capital requirements implements the Dodd-Frank Act as to savings and loan holding companies. Consolidated regulatory capital requirements identical to those applicable to the subsidiary depository institutions will apply to savings and loan holding companies as of January 1, 2015. As is the case with institutions themselves, the capital conservation buffer will be phased in between 2016 and 2019.

**Source of Strength Doctrine.** The "source of strength doctrine" requires bank holding companies to provide financial assistance to their subsidiary depository institutions in the event the subsidiary depository institution experiences financial distress. The Dodd-Frank Act extends the source of strength doctrine to savings and loan holding companies. The FRB has issued regulations requiring that all bank holding companies and savings and loan holding companies serve as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial distress.

The FRB has issued a policy statement regarding the payment of dividends by bank holding companies that it has made applicable to savings and loan holding companies as well. In general, the policy provides that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. Regulatory guidance provides for prior regulatory review of capital distributions in certain circumstances such as where the company's net income for the past four quarters, net of dividends previously paid over that period, is insufficient to fully fund the dividend or the company's overall rate of earnings retention is inconsistent with the company's capital needs and overall financial condition. The ability of a holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of the Company to pay dividends or otherwise engage in capital distributions.

## **Change in Control Regulations**

Under the Change in Bank Control Act, no person may acquire control of a savings and loan holding company such as the Company unless the FRB has been given 60 days' prior written notice and has not issued a notice disapproving the proposed acquisition, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the competitive effects of the acquisition. Control, as defined under federal law, means ownership, control of or holding irrevocable proxies representing more than 25% of any class of voting stock, control in any manner of the election of a majority of the company's directors, or a determination by the regulator that the acquirer has the power to direct, or directly or indirectly to exercise a controlling influence over, the management or policies of the institution. Acquisition of more than 10% of any class of a savings

and loan holding company's voting stock constitutes a rebuttable presumption of control under the regulations under certain circumstances including where, as is the case with the Company, the issuer has registered securities under Section 12 of the Exchange Act.

### **Sarbanes-Oxley Act of 2002**

The Sarbanes-Oxley Act of 2002 was enacted in response to public concerns regarding corporate accountability in connection with certain accounting scandals. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The Sarbanes-Oxley Act generally applies to all companies that file or are required to file periodic reports with the SEC, under the Exchange Act.

The Sarbanes-Oxley Act includes specific additional disclosure requirements, requires the SEC and national securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules, and mandates further studies of certain issues by the SEC.

### **Federal Securities Laws**

The Company's common stock is registered with the SEC under the Exchange Act. The Company is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the Exchange Act.

## **ITEM 1A. RISK FACTORS**

An investment in our securities is subject to risks inherent in our business and the industry in which we operate. Before making an investment decision, you should carefully consider the risks and uncertainties described below and all other information included in this report. The risks described below may adversely affect our business, financial condition and operating results. In addition to these risks and the other risks and uncertainties described in Item 1, "Business-Forward Looking Statements," and Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," there may be additional risks and uncertainties that are not currently known to us or that we currently deem to be immaterial that could materially and adversely affect our business, financial condition or operating results. The value or market price of our securities could decline due to any of these identified or other risks. Past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

### **Our future growth and success will depend on our ability to compete effectively in a highly competitive environment**

We face substantial competition in all phases of our operations from a variety of different competitors. Our future growth and success will depend on our ability to compete effectively in this highly competitive environment. To date, our competitive strategies have focused on attracting deposits in our local markets, and growing our loan and lease portfolio by emphasizing specific loan products in which we have significant experience and expertise, identifying and targeting markets in which we believe we can effectively compete with larger institutions and other competitors, and offering highly competitive pricing to commercial borrowers with low risk profiles. We compete for loans, deposits and other financial services with other commercial banks, thrifts, credit unions, brokerage houses, mutual funds, insurance companies, real estate conduits, mortgage brokers and specialized finance companies. Many of our competitors offer products and services that we do not offer, and many have substantially greater resources and lending limits, name recognition and market presence that benefit them in attracting business. In addition, larger competitors may be able to price loans and deposits more aggressively than we do, and because of their larger capital bases, their underwriting practices for smaller loans may be subject to less regulatory scrutiny than they would be for smaller banks. Newer competitors may be more aggressive in pricing loans and deposits in order to increase their market share. Some of the financial institutions and financial services organizations with which we compete are not subject to the extensive regulations imposed on federal savings banks and their holding companies. As a result, these nonbank competitors have certain advantages over us in accessing funding and in providing various financial services.

### **Numerous factors could adversely impact future loan growth and thus our future profitability**

Our future profitability will depend in substantial part on our ability to achieve loan and lease growth under intensely competitive conditions in a manner consistent with our underwriting standards and business plan objectives. Our ability to achieve future loan and lease growth will depend on a number of factors, including our ability to offer loan and lease products at prices and with features that are comparable or superior to those offered by our competitors and attractive to potential borrowers. Because our business plan targets high quality loans and leases in specific markets and product categories, our underwriting standards and our lending requirements relating to collateral eligibility, residual equity, global debt service coverage, loan covenants, loan structure and financial reporting tend to be on the conservative side of the market. This can make it difficult for us to compete with institutions

that have comparable loan pricing but more lenient lending requirements. Our loan pricing is also impacted in a significant way by the financial strength of the borrower, the guarantor and the collateral. This enables us to compete very effectively for highly qualified borrowers, but it can place us at a competitive disadvantage with respect to borrowers who present acceptable credit risks but are not highly qualified. Our ability to achieve future loan and lease growth will also be affected by factors that are not exclusively within our control, such as the level of loan payoffs and regulatory concentrations of credit limits. These and other factors could weaken our competitive position, which could adversely affect our growth and profitability. This, in turn, could have a material adverse effect on our business, financial condition, and results of operations.

**Since our business is concentrated in the Chicago Metropolitan Area, local economic, market and competitive conditions can adversely affect our business**

Although we make certain types of loans and leases to borrowers located in other states, our lending and deposit gathering activities are concentrated primarily in the Chicago Metropolitan Area. Our success can be affected by the general economic conditions of this area and surrounding areas. In addition, many of the loans in our loan portfolio are secured by real estate located in the Chicago Metropolitan Area. Negative conditions in the real estate markets where collateral for a mortgage loan is located could adversely affect the borrower's ability to repay the loan and the value of the collateral securing the loan. Real estate values are affected by many other factors beyond our control, including real estate supply and demand, the impact of mortgage foreclosures and short sales, changes in general or regional economic conditions and unemployment rates, interest rates, governmental rules or policies and natural disasters. The value of real estate located in many segments of the Chicago Metropolitan Area has been and continues to be adversely impacted by many of these factors, and this has had, and may continue to have, a negative impact on our loan growth, our ability to collect certain loans according to their terms and market other real estate loans at appraised values, and our results of operations.

The commercial, multi-family and residential real estate markets in the Chicago area continue to experience a variety of difficulties, including an oversupply of properties in some market segments due to economic conditions, high unemployment rates and a high level of foreclosed properties and properties in the process of foreclosure. These adverse conditions have had a variety of adverse consequences for both lenders and borrowers, including a reduction in the value of real estate collateral and OREO, an increase in loan to value ratios, higher vacancy rates and lower rents, a reduction of the borrowing capacity of real estate borrowers and an increase in strategic defaults resulting from the reduction or elimination of the equity that borrowers once had in their real estate investments.

**Historically low interest rates could continue to adversely affect our net interest income and profitability**

Our consolidated operating results are largely dependent on our net interest income. Net interest income is the difference between interest earned on loans and investments and interest expense incurred on deposits and other borrowings. Our net interest income is impacted by changes in market rates of interest, changes in credit spreads, changes in the shape of the yield curve, the interest rate sensitivity of our assets and liabilities, prepayments on our loans and investments, and the mix of our funding sources and assets, among other things.

In recent years it has been the policy of the Board of Governors of the Federal Reserve System to maintain interest rates at historically low levels through its targeted federal funds rate and the purchase of securities. As a result, the interest rates on new loans we have originated and maturing loans that we have renewed and the yields on securities we have purchased during this period have been at historically low levels. Our ability to offset this by lowering the interest rates that we pay on deposits is severely limited because interest rates on deposits are already at historic lows. These factors contributed to a 58 basis points decline in our net interest spread in 2013. The Board of Governors of the Federal Reserve System has indicated its intention to maintain low interest rates until the national unemployment rate is 6.5% or lower. Accordingly, our net interest income (the difference between interest income earned on assets and interest expense paid on liabilities) may continue to decrease, which may have an adverse effect on our profitability.

**Changes in market interest rates could adversely affect our financial condition and results of operations**

Our financial condition and results of operations are significantly affected by changes in market interest rates because our assets, primarily loans, and our liabilities, primarily deposits, are monetary in nature. Our results of operations depend substantially on our net interest income, which is the difference between the interest income that we earn on our interest-earning assets and the interest expense that we pay on our interest-bearing liabilities. Market interest rates are affected by many factors beyond our control, including inflation, recession, unemployment, money supply, domestic and international events, and changes in the United States and other financial markets. Our net interest income is affected not only by the level and direction of interest rates, but also by the shape of the yield curve and relationships between interest sensitive instruments and key driver rates, including credit risk spreads, and by balance sheet growth, customer loan and deposit preferences and the timing of changes in these variables which

themselves are impacted by changes in market interest rates. As a result, changes in market interest rates can significantly affect our net interest income as well as the fair market valuation of our assets and liabilities.

While we take measures intended to manage the risks from changes in market interest rates, we cannot control or accurately predict changes in market rates of interest or be sure our protective measures are adequate. If the interest rates paid on deposits and other interest bearing liabilities increase at a faster rate than the interest rates received on loans and other interest earning assets, our net interest income, and therefore earnings, could be adversely affected. We would also incur a higher cost of funds to retain our deposits in a rising interest rate environment. While the higher payment amounts we would receive on adjustable rate loans in a rising interest rate environment may increase our interest income, some borrowers may be unable to afford the higher payment amounts, and this could result in a higher rate of default. Rising interest rates also may reduce the demand for loans and the value of fixed-rate investment securities.

**Repayment of our commercial and commercial real estate loans typically depends on the cash flows of the borrower. If a borrower's cash flows weaken or become uncertain, the loan may need to be classified, the collateral securing the loan may decline in value and we may need to increase our loan loss reserves or record a charge off**

We underwrite our commercial and commercial real estate loans primarily based on the historical and expected cash flow of the borrower. Although we consider collateral in the underwriting process, it is a secondary consideration that generally relates to the risk of loss in the event of a borrower default. We have also adopted the OCC's published guidance for assigning risk-ratings to loans, and it emphasizes the strength of the borrower's cash flow. Specifically, the OCC's loan risk-rating guidance provides that the primary consideration in assigning risk-ratings to commercial and commercial real estate loans is the strength of the primary source of repayment, which is defined as a sustainable source of cash under the borrower's control that is reserved, explicitly or implicitly, to cover the debt obligation. The OCC's loan risk-rating guidance typically does not consider secondary repayment sources until the strength of the primary repayment source weakens, and collateral values typically do not have a significant impact on a loan's risk ratings until a loan is classified. Consequently, if a borrower's cash flows weaken or become uncertain, the loan may need to be classified, whether or not the loan is performing or fully secured. In addition, real estate appraisers typically place significant weight on the cash flows generated by income-producing real estate and the reliability of the cash flows in performing valuations. Thus, economic or borrower-specific conditions that cause a decline in borrower cash flows could cause our loan classifications to increase and the appraised value of the collateral securing our loans to decline, and require us to increase our loan loss reserves or record charge offs.

**If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings would be adversely impacted**

In the event that our loan customers do not repay their loans according to their terms, and the collateral securing the repayment of these loans is insufficient to cover any remaining loan balance, we could experience significant loan losses or increase our provision for loan losses or both, which could have a material adverse effect on our operating results. At December 31, 2013, our allowance for loan losses was \$14.2 million, representing 1.3% of total loans and 76.9% of nonperforming loans as of that date. In determining the amount of our allowance for loan losses, we rely on our loan quality reviews, our experience and our evaluation of economic conditions, among other factors. In addition, we make various estimates and assumptions about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets, if any, serving as collateral for the repayment of our loans. We also make judgments concerning our legal positions and the priority of our interests in contested legal or bankruptcy proceedings, and at times, we may lack sufficient information to establish adequate specific reserves for loans involved in such proceedings. We base these estimates, assumptions and judgments on information that we consider reliable, but if an estimate, assumption or judgment that we make ultimately proves to be incorrect, additional provisions to our allowance for loan losses may become necessary. In addition, as an integral part of their supervisory and/or examination process, our regulatory agencies periodically review the methodology and sufficiency of the allowance for loan losses. These agencies may require us to recognize additions to the allowance based on their inclusion, exclusion or modification of risk factors or differences in judgments of information available to them at the time of their examination.

**A substantial portion of our loan portfolio is secured by real estate. Deterioration in the real estate markets could lead to additional losses, which could have a material negative effect on our financial condition and results of operations**

A substantial portion of our loan portfolio is secured by real estate. At December 31, 2013, our loan portfolio included \$396.1 million in multi-family mortgage loans, or 35.6% of total loans, \$263.6 million in nonresidential real estate loans, or 23.7% of total loans, \$201.4 million in one-to four family residential real estate loans, or 18.1% of total loans (which includes \$54.9 million in non-owner occupied one-to four family residential real estate loans, or 4.9% of total loans) and \$6.6 million in construction and land loans, or 0.6% of total loans. . Adverse conditions in the real estate markets, particularly in the Chicago area, have been a significant factor behind the higher than normal charge-offs and provisions for loan losses we have experienced in recent years. As a result of these and other factors, we have experienced higher levels of charge-offs, loan classifications and provisions for

loan losses on our real estate loans and write-downs on our other real estate owned. The persistence of these adverse conditions could result in additional defaults, charge-offs, provisions for loan losses and loan classifications.

**Repayment of our lease loans is typically dependent on the cash flows of the lessee, which may be unpredictable, and the collateral securing these loans may fluctuate in value**

We lend money to small and mid-sized independent leasing companies to finance the debt portion of leases. A lease loan arises when a leasing company discounts the equipment rental revenue stream owed to the leasing company by a lessee. Our lease loans entail many of the same types of risks as our commercial loans. Lease loans generally are non-recourse to the leasing company, and, consequently, our recourse is limited to the lessee and the leased equipment. As with commercial loans secured by equipment, the equipment securing our lease loans may depreciate over time, may be difficult to appraise and may fluctuate in value. We rely on the lessee's continuing financial stability, rather than the value of the leased equipment, for the repayment of all required amounts under lease loans. In the event of a default on a lease loan, the proceeds from the sale of the leased equipment may not be sufficient to satisfy the outstanding unpaid amounts under the terms of the loan. At December 31, 2013, our lease loans totaled \$187.1 million, or 16.8% of our total loan portfolio.

**Our loan portfolio includes loans to healthcare providers, and the repayment of these loans is largely dependent upon the receipt of governmental reimbursements**

At December 31, 2013, we had \$37.1 million of loans and unused commitments to a variety of healthcare providers, primarily lines of credit secured by healthcare receivables. The repayment of these lines of credit is largely dependent on the borrower's receipt of payments and reimbursements under Medicaid, Medicare and in some cases private insurance contracts for the services they have provided. The ability of the borrowers to service loans we have made to them may be adversely impacted by the financial health of the state or federal payors, many of which have experienced budgetary stress, to make reimbursements for the services provided. The failure of one or more state or federal payors to make reimbursements owed to the operators of these facilities, or a significant delay in the making of such reimbursements, could adversely affect the ability of the operators of these facilities to repay their obligations to us. In addition, changes to national health care policy involving private health insurance policies may also affect the business prospects and financial condition or operations of commercial loan customers and commercial lessees involved in health care-related businesses

**The Bank is required to maintain a significant percentage of its total assets in residential mortgage loans and investments secured by residential mortgage loans, which restricts our ability to diversify our loan portfolio**

A federal savings bank or thrift differs from a commercial bank in that it is required to maintain at least 65% of its total assets in "qualified thrift investments" which generally include loans and investments, for the purchase, refinance, construction, improvement, or repair of residential real estate, as well as home equity loans, education loans and small business loans. To maintain our federal savings bank charter we have to be a "qualified thrift lender" or "QTL" in nine out of each 12 immediately preceding months. The QTL requirement limits the extent to which we can grow our commercial loan portfolio, and as a result of the Dodd-Frank Act, failing the QTL test can result in an enforcement action. However, multi-family mortgage loans as well as certain loans not exceeding \$2 million (including a group of loans to one borrower) that are for commercial, corporate, business, or agricultural purposes are included in our qualified thrift investments. Because of the QTL requirement, we may be limited in our ability to change our asset mix and increase the yield on our earning assets by growing our commercial loan portfolio.

**The residential loans in our loan portfolio are sensitive to regional and local economic conditions**

We originate fixed and adjustable rate loans secured by one- to four-family residential real estate. Our general practice is to sell a majority of our newly originated fixed-rate residential real estate loans and to hold in portfolio a limited number of adjustable-rate residential real estate loans. Our portfolio also includes home equity lines of credit and fixed-rate second mortgage loans. Residential real estate lending is sensitive to regional and local economic conditions that significantly impact the ability of borrowers to meet their loan payment obligations, making loss levels difficult to predict. The decline in residential real estate values as a result of the downturn in the Chicago Metropolitan Area housing markets has generally reduced the value of the real estate collateral securing these types of loans and increased the risk that we will incur losses if borrowers default on their loans. Residential loans with high combined loan-to-value ratios generally will be more sensitive to declining property values than those with lower combined loan-to-value ratios and therefore may experience a higher incidence of default and severity of losses. In addition, if the borrowers sell their homes, the borrowers may be unable to repay their loans in full from the sale proceeds. As a result, these loans may experience higher rates of delinquencies, defaults and losses, which could in turn adversely affect our financial condition and results of operations.

### **Proposed and final regulations could restrict our ability to originate and sell residential loans**

The Consumer Financial Protection Bureau has issued a rule designed to clarify for lenders how they can avoid legal liability under the Dodd-Frank Act, which would hold lenders accountable for ensuring a borrower's ability to repay a mortgage. Loans that meet this "qualified mortgage" definition will be presumed to have complied with the new ability-to-repay standard. Under the Consumer Financial Protection Bureau's rule, a "qualified mortgage" loan must not contain certain specified features, including:

- excessive up-front points and fees (those exceeding 3% of the total loan amount, less "bona fide discount points" for prime loans);
- interest-only payments;
- negative-amortization; and
- terms longer than 30 years.

Also, to qualify as a "qualified mortgage," a borrower's total monthly debt-to-income ratio may not exceed 43%. Lenders must also verify and document the income and financial resources relied upon to qualify the borrower for the loan and underwrite the loan based on a fully amortizing payment schedule and maximum interest rate during the first five years, taking into account all applicable taxes, insurance and assessments. The Consumer Financial Protection Bureau's rule on qualified mortgages could limit our ability or desire to make certain types of loans or loans to certain borrowers, or could make it more expensive/and or time consuming to make these loans, which could limit our growth or profitability.

In addition, the Dodd-Frank Act requires the regulatory agencies to issue regulations that require securitizers of loans to retain not less than 5% of the credit risk for any asset that is not a "qualified residential mortgage." The regulatory agencies have issued a proposed rule to implement this requirement. The Dodd-Frank Act provides that the definition of "qualified residential mortgage" can be no broader than the definition of "qualified mortgage" issued by the Consumer Financial Protection Bureau for purposes of its regulations. Although the final rule with respect to the retention of credit risk has not yet been issued, the final rule could have a significant effect on the secondary market for loans and the types of loans we originate, and restrict our ability to make loans.

### **Losses incurred in connection with actual or projected repurchases and make-whole payments related to certain residential mortgages that we have sold to Fannie Mae may exceed our financial statement reserves and we may be required to increase such reserves in the future**

We have engaged in the origination and purchase of residential and multifamily mortgages for sale to third parties, primarily Fannie Mae. In connection with such sales, we made certain representations and warranties, and were required to observe certain underwriting and documentation requirements. If we breached any representation or warranty relating to a sold loan or did not observe the applicable underwriting and documentation requirements, the purchaser may request us to repurchase the loan, and if the loan resulted in a loss, the purchaser may request us to make it whole for the amount of the loss. We have from time to time received requests from loan purchasers to repurchase loans or to make the purchaser whole for losses sustained on a loan. We have successfully defended our positions in the majority of such cases, but in several cases, our asserted defenses did not prevail. We intend to defend any loan repurchase requests or make whole payment requests that we may receive in the future if we believe that we have meritorious defenses. We have also established a representation and warranty reserve for potential losses that may result from any such requests that we are not able to successfully defend, using a methodology that we believe is appropriate. It is possible that we will receive future loan repurchase requests or make whole payment requests. If we are required to make loan repurchases or make whole payments in excess of our representation and warranty reserves or if we need to increase our reserves, this could have a material adverse effect on our financial condition and results of operations.

### **Our business may be adversely affected by the regulatory environment in which we operate**

The Dodd-Frank Act, which was signed by the President on July 21, 2010, provided for the transfer of the authority for regulating and supervising federal savings banks from the OTS to the OCC, and the authority for regulating and supervising savings and loan holding companies and their non-depository subsidiaries from the OTS to the FRB. The transfer occurred on July 21, 2011, and on that date, the OCC became the primary federal regulator of the Bank and the FRB became the primary federal regulator of the Company. The transition of the Company and the Bank to this new supervisory and regulatory structure presents risks, potential limitations and adjustments that were not present when the Company and the Bank were supervised and regulated exclusively by the OTS. For example, the OCC's published guidance and practices for assigning risk ratings to commercial loans focuses more heavily on cash flows than the loan risk rating guidance and practices of the OTS, and requires that a performing loan be classified if it exhibits well-defined weaknesses, even if the loan does not present a probability of default or loss. The OCC's more stringent loan risk-rating practices have contributed to the increase in the Bank's classified loans and have increased the Bank's risk of being subjected to supervisory measures. In addition, the Federal Reserve Board takes a more comprehensive approach than the OTS



did to holding company supervision and regulation. For example, the Company is now subject to Federal Reserve Board Supervisory Letter SR 09-4, which has the effect of imposing restrictions on dividends and stock repurchases in certain circumstances. The Company does not have sufficient net income for the past four quarters net of dividends previously paid to declare a dividend without first consulting with and seeking the approval of the Federal Reserve Bank of Chicago. The Company's ability to pay dividends on its common stock could be further limited by the application of the Federal Reserve Board's source of strength doctrine, which requires holding companies to provide financial support to their subsidiary depository institutions if the subsidiary is in financial distress, or by regulatory order. These regulatory changes have affected, and will continue to affect, the regulatory environment in which we operate.

#### **FDIC deposit insurance costs have increased and may increase further in the future**

FDIC insurance rates have increased significantly, and we may pay higher FDIC deposit premiums in the future. The Dodd-Frank Act established 1.35% as the minimum Designated Reserve Ratio ("DRR") for the deposit insurance fund. The FDIC has determined that the DRR should be 2.0% and has adopted a plan under which it will meet the statutory minimum DRR of 1.35% by the statutory deadline of September 30, 2020. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets less than \$10 billion of the increase in the statutory minimum DRR to 1.35% from the former statutory minimum of 1.15%. The FDIC has not announced how it will implement this offset. The Dodd-Frank Act also requires the FDIC to base deposit insurance premium on an institution's total assets minus its tangible equity instead of its deposits. The FDIC has adopted regulations that base assessments for banks and thrifts with total assets of less than \$10 billion on a combination of financial ratios and regulatory ratings. This new method has caused our FDIC deposit insurance premiums to increase and presents a risk that they will increase in the future. If circumstances require the FDIC to impose additional special assessments or further increase its quarterly assessment rates, this could also have an adverse impact on our results of operations.

#### **We will become subject to more stringent capital requirements, which may adversely impact our return on equity, require us to raise additional capital, or constrain us from paying dividends or repurchasing shares**

In July 2013, the federal banking agencies approved a new rule that will substantially amend the regulatory risk-based capital rules applicable to the Bank and the Company. The final rule implements the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act.

The final rule includes new minimum risk-based capital and leverage ratios, which will be effective for us on January 1, 2015, and refines the definition of what constitutes "capital" for purposes of calculating these ratios. The new minimum capital requirements will be: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 to risk-based assets capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4%. The final rule also requires unrealized gains and losses on certain "available-for-sale" securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt-out is exercised. The final rule also establishes a "capital conservation buffer" of 2.5%, and will result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 to risk-based assets capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement would be phased in beginning in January 2016 at 0.625% of risk-weighted assets and would increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that can be utilized for such actions.

We have analyzed the effects of these new capital requirements, and we believe that the Bank and the Company would meet all of these new requirements, including the full 2.5% capital conservation buffer, as if these new requirements had been in effect as of December 31, 2013.

The application of more stringent capital requirements could, among other things, result in lower returns on equity, require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Implementation of changes to asset risk weightings for risk-based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy, and could limit our ability to make distributions, including paying out dividends or buying back shares. Specifically, beginning in 2016, the Bank's ability to pay dividends will be limited if does not have the capital conservation buffer required by the new capital rules, which may limit our ability to pay dividends to stockholders. See "Supervision and Regulation-Federal Banking Regulation-New Capital Rule."

### **Our sources of funds are limited because of our holding company structure**

The Company is a separate legal entity from its subsidiaries and does not have significant operations of its own. Dividends from the Bank provide a significant source of cash for the Company. The availability of dividends from the Bank is limited by various statutes and regulations. Under these statutes and regulations, the Bank is not permitted to pay dividends on its capital stock to the Company, its sole stockholder, if the dividend would reduce the stockholders' equity of the Bank below the amount of the liquidation account established in connection with the mutual-to-stock conversion. Federal savings banks may pay dividends without the approval of its primary federal regulator only if they meet applicable regulatory capital requirements before and after the payment of the dividends and total dividends do not exceed net income to date over the calendar year plus its retained net income over the preceding two years. Although the Bank's capital exceeded applicable regulatory requirements at December 31, 2013, the Bank did not have sufficient net income over the preceding two years to pay a dividend to the Company without receiving prior regulatory approval. The Company has also reserved \$5.0 million of its available cash to maintain its ability to serve as a source of financial strength to the Bank. If in the future, the Company utilizes its available cash for other purposes and the Bank is unable to pay dividends to the Company, the Company may not have sufficient funds to pay dividends.

### **New or changing tax, accounting, and regulatory rules and interpretations could have a significant impact on our strategic initiatives, results of operations, cash flows, and financial condition**

The banking services industry is extensively regulated and the degree of regulation is increasing due to the Dodd-Frank Act and regulatory initiatives precipitated by the Dodd-Frank Act and the economic downturn and the resulting disruptions that certain financial markets experienced. These regulations, along with the currently existing tax, accounting, securities, insurance, and monetary laws, regulations, rules, standards, policies and interpretations, control the methods by which financial institutions and their holding companies conduct business, engage in strategic and tax planning and implement strategic initiatives, and govern financial reporting and disclosures. These laws, regulations, rules, standards, policies and interpretations are constantly evolving and may change significantly over time.

### **We are subject to security and operational risks relating to our use of technology**

We depend on the secure processing, storage and transmission of confidential and other information in our data processing systems, computers, networks and communications systems. Although we take numerous protective measures and otherwise endeavor to protect and maintain the privacy and security of confidential data, these systems may be vulnerable to unauthorized access, computer viruses or other malicious code, and other events that could have a security impact. If one or more of such events were to occur, this potentially could jeopardize confidential and other information processed and stored in, and transmitted through, our systems or otherwise cause interruptions or malfunctions in our or our customers' operations. We may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are not fully covered by our insurance. Security breaches in our internet banking activities could expose us to possible liability and deter customers from using our systems. We rely on standard internet security systems to provide the security and authentication necessary to effect secure transmission of data. These precautions may not fully protect our systems from compromises or breaches of our security measures that could result in damage to our reputation and our business. Although we perform most data processing functions internally, we outsource certain services to third parties. If our third party providers encounter operational difficulties or security breaches, it could affect our ability to adequately process and account for customer transactions, which could significantly affect our business operations.

### **Our operations rely on numerous external vendors**

We rely on numerous external vendors to provide us with products and services necessary to maintain our day-to-day operations. Accordingly, our operations are exposed to risk that these vendors will not perform in accordance with the contracted arrangements under service level agreements. The failure of an external vendor to perform in accordance with the contracted arrangements under service level agreements because of changes in the vendor's organizational structure, financial condition, support for existing products and services or strategic focus or for any other reason, could be disruptive to our operations, which in turn could have a material negative impact on our financial condition and results of operations. We also could be adversely affected to the extent such an agreement is not renewed by the third party vendor or is renewed on terms less favorable to us.

### **Our business and operations could be significantly impacted if we or our third party vendors suffer failure or disruptions of information processing systems or systems failures**

We have become increasingly dependent on communications, data processing and other information technology systems to manage and conduct our business and support our day-to-day banking, investment, and trust activities, some of which are provided through third-parties. If we or our third party vendors encounter difficulties or become the source of an attack on or breach of their operational systems, data or infrastructure, or if we have difficulty communicating with any such third party system, our business and operations

could suffer. Any failure or disruption to our systems, or those of a third party vendor, could impede our transaction processing, service delivery, customer relationship management, data processing, financial reporting or risk management. Although we take ongoing monitoring, detection, and prevention measures and perform penetration testing and periodic risk assessments, our computer systems, software and networks and those of our third party vendors may be or become vulnerable to unauthorized access, loss or destruction of data (including confidential client information), account takeovers, unavailability of service, computer viruses, denial of service attacks, malicious social engineering or other malicious code, or cyber-attacks beyond what we can reasonably anticipate and such events could result in material loss. If any of our financial, accounting or other data processing systems fail or have other significant shortcomings, we could be materially adversely affected. Security breaches in our online banking systems could also have an adverse effect on our reputation and could subject us to possible liability. Additionally, we could suffer disruptions to our systems or damage to our network infrastructure from events that are wholly or partially beyond our control, such as electrical or telecommunications outages, natural disasters, widespread health emergencies or pandemics, or events arising from local or larger scale political events, including terrorist acts. There can be no assurance that our policies, procedures and protective measures designed to prevent or limit the effect of a failure, interruption or security breach, or the policies, procedures and protective measures of our third party vendors, will be effective. If significant failure, interruption or security breaches do occur in our processing systems or those of our third party providers, we could suffer damage to our reputation, a loss of customer business, additional regulatory scrutiny, or exposure to civil litigation, additional costs and possible financial liability. In addition, our business is highly dependent on our ability to process, record and monitor, on a continuous basis, a large number of transactions. To do so, we are dependent on our employees and therefore, the potential for operational risk exposure exists throughout our organization, including losses resulting from human error. We could be materially adversely affected if one or more of our employees cause a significant operational breakdown or failure. If we fail to maintain adequate infrastructure, systems, controls and personnel relative to our size and products and services, our ability to effectively operate our business may be impaired and our business could be adversely affected.

**We continually encounter technological change, and may have fewer resources than many of our competitors to continue to invest in technological improvements**

The financial services industry is undergoing rapid technological changes, with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We also may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

**Trading activity in the Company's common stock could result in material price fluctuations**

It is possible that trading activity in the Company's common stock, including short-selling or significant sales by our larger stockholders, could result in material price fluctuations of the price per share of the Company's common stock. In addition, such trading activity and the resultant volatility could make it more difficult for the Company to sell equity or equity-related securities in the future at a time and price it deems appropriate, or to use its stock as consideration for an acquisition.

**Various factors may make takeover attempts that you might want to succeed more difficult to achieve, which may affect the value of shares of our common stock**

Provisions of our articles of incorporation and bylaws, federal regulations, Maryland law and various other factors may make it more difficult for companies or persons to acquire control of the Company without the consent of our board of directors. You may want a takeover attempt to succeed because, for example, a potential acquirer could offer a premium over the then prevailing price of our shares of common stock. Provisions of our articles of incorporation and bylaws also may make it difficult to remove our current board of directors or management if our board of directors opposes the removal. We have elected to be subject to the Maryland Business Combination Act, which places restrictions on mergers and other business combinations with large stockholders. In addition, our articles of incorporation provide that certain mergers and other similar transactions, as well as amendments to our articles of incorporation, must be approved by stockholders owning at least two-thirds of our shares of common stock entitled to vote on the matter unless first approved by at least two-thirds of the number of our authorized directors, assuming no vacancies. If approved by at least two-thirds of the number of our authorized directors, assuming no vacancies, the action must still be approved by a majority of our shares entitled to vote on the matter. In addition, a director can be removed from office, but only for cause, if such removal is approved by stockholders owning at least two-thirds of our shares of common stock entitled to vote on the matter. However, if at least two-thirds of the number of our authorized directors, assuming no vacancies, approves the removal of a director, the removal may be with or without cause, but must still be approved by a majority of our voting shares entitled to vote

on the matter. Additional provisions include limitations on the voting rights of any beneficial owners of more than 10% of our common stock. Our bylaws, which can only be amended by the board of directors, also contain provisions regarding the timing, content and procedural requirements for stockholder proposals and nominations.

**New lines of business or new products and services may subject us to additional risks**

From time to time, we may seek to implement new lines of business or offer new products and services within existing lines of business in our current markets or new markets. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services, we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible, which could in turn have a material negative effect on our operating results.

**Non-Compliance with USA PATRIOT Act, Bank Secrecy Act, Real Estate Settlement Procedures Act, Truth-in-Lending Act or other laws and regulations could result in fines or sanctions**

Financial institutions are required under the USA PATRIOT and Bank Secrecy Acts to develop programs to prevent financial institutions from being used for money-laundering and terrorist activities. Financial institutions are also obligated to file suspicious activity reports with the U.S. Treasury Department's Office of Financial Crimes Enforcement Network if such activities are detected. These rules also require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure or the inability to comply with these regulations could result in fines or penalties, curtailment of expansion opportunities, intervention or sanctions by regulators and costly litigation or expensive additional controls and systems. During the last few years, several banking institutions have received large fines for non-compliance with these laws and regulations. In addition, the U.S. Government imposed and will continue to expand laws and regulations relating to residential and consumer lending activities that create significant new compliance burdens and financial risks. We have developed policies and continue to augment procedures and systems designed to assist in compliance with these laws and regulations.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

We conduct our business at 20 banking offices located in the Chicago metropolitan area. We own a majority of our banking center facilities, except for our Chicago-Lincoln Park, Northbrook, and Chicago-Hyde Park East offices, which are leased. The Hyde Park East office was closed effective January 2, 2014. We also operate two satellite national commercial leasing offices. We believe that all of our properties and equipment are well maintained, in good operating condition and adequate for all of our present and anticipated needs.

We believe our facilities in the aggregate are suitable and adequate to operate our banking and related business. Additional information with respect to premises and equipment is presented in Note 6 of "Notes to Consolidated Financial Statements" in Item 8 of the Form 10-K.

**ITEM 3. LEGAL PROCEEDINGS**

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

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our shares of common stock are traded on the NASDAQ Global Select Market under the symbol "BFIN." The approximate number of holders of record of the Company's common stock as of December 31, 2013 was 1,540. Certain shares of the Company's common stock are held in "nominee" or "street" name, and accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number.

The following table presents quarterly market information provided by the NASDAQ Stock Market for the Company's common stock and cash dividends paid for the periods ended December 31, 2013 and 2012.

<b>2012 and 2013 Quarterly Periods</b>	<b>High</b>	<b>Low</b>	<b>Close</b>	<b>Cash Dividends Paid</b>
Quarter ended December 31, 2013	\$ 9.74	\$ 8.70	\$ 9.16	\$ 0.02
Quarter ended September 30, 2013	9.40	8.15	8.84	—
Quarter ended June 30, 2013	8.71	7.25	8.50	0.02
Quarter ended March 31, 2013	8.40	7.19	8.09	—
Quarter ended December 31, 2012	\$ 8.85	\$ 6.62	\$ 7.42	\$ —
Quarter ended September 30, 2012	9.24	7.31	8.79	0.01
Quarter ended June 30, 2012	7.56	5.66	7.53	0.01
Quarter ended March 31, 2012	7.05	5.25	6.62	0.01

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

The Company is also subject to state law limitations on the payment of dividends. Maryland law generally limits dividends to an amount equal to the excess of our capital surplus over payments that would be owed upon dissolution to stockholders whose preferential rights upon dissolution are superior to those receiving the dividend, and to an amount that would not make us insolvent provided, however, that even if the Company's assets are less than the amount necessary to satisfy the requirement set forth above, the Company may make a distribution from: (1) the Company's net earnings for the fiscal year in which the distribution is made; (2) the Company's net earnings for the preceding fiscal year; or (3) the sum of the Company's net earnings for the preceding eight fiscal quarters. Dividends from the Bank provide a significant source of cash for the Company. The availability of dividends from the Bank is limited by various statutes and regulations. For a discussion of the Bank's ability to pay dividends, see Part I, Item 1, "Business — Supervision and Regulation — Federal Banking Regulation — Capital Distributions."

#### **Recent Sales of Unregistered Securities**

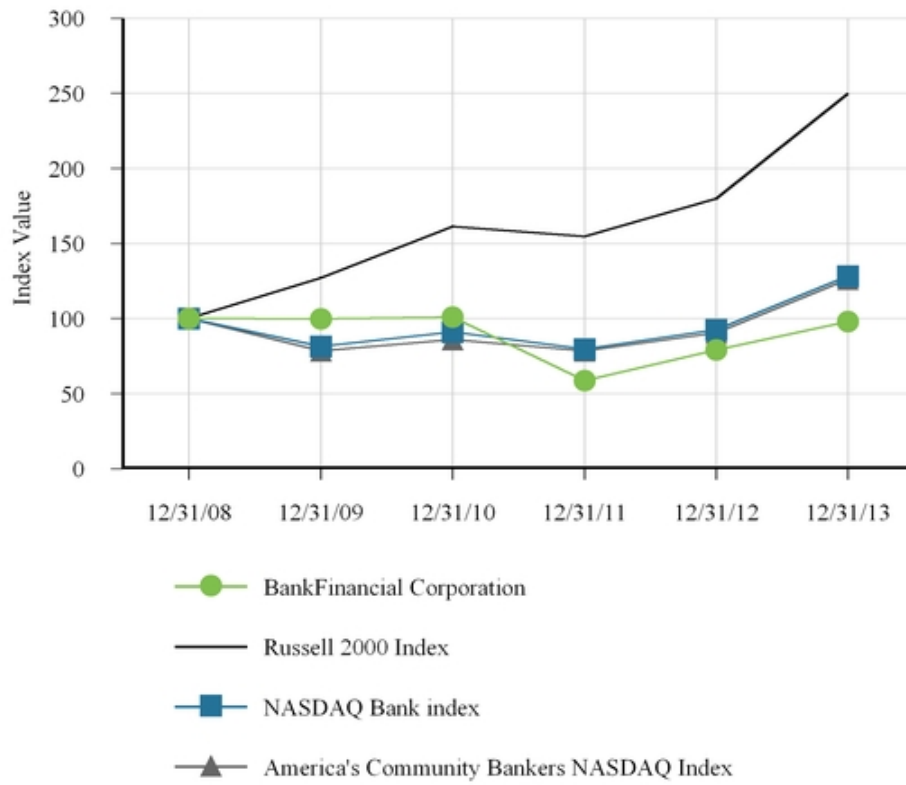
The Company had no sales of unregistered stock during the quarter ended December 31, 2013.

#### **Repurchases of Equity Securities**

Our Board of Directors had authorized the repurchase of up to 5,047,423 shares of our common stock. The repurchase authorization expired on November 15, 2012. The authorization permitted shares to be repurchased in open market or negotiated transactions, and pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission. The authorization was utilized at management's discretion, subject to the limitations set forth in Rule 10b-18 of the Securities and Exchange Commission and other applicable legal requirements, and to price and other internal limitations established by the Board of Directors. As of December 31, 2013, the Company had repurchased 4,239,134 shares of its common stock out of the 5,047,423 shares that had been authorized for repurchase. Federal Reserve Board Supervisory Letter SR 09-4 provides that holding companies experiencing financial weaknesses such as operating losses should notify and make a submission to the Federal Reserve Bank before redeeming or repurchasing common stock. The Company has no plans to conduct such discussions with the Federal Reserve supervisory staff or engage in stock repurchases at this time.

### Stock Performance Graph

The following line graph shows a comparison of the cumulative returns for the Company, the Russell 2000 Index, the NASDAQ Bank Index and the America's Community Bankers NASDAQ Index for the period beginning December 31, 2008 and ending December 31, 2013. The information assumes that \$100 was invested at the closing price on December 31, 2008 in the Common Stock and each index, and that all dividends were reinvested.



	12/31/2008	12/31/2009	12/31/2010	12/31/2011	12/31/2012	12/31/2013
BankFinancial Corporation	100.00	99.83	101.05	58.58	78.97	97.88
Russell 2000 Index	100.00	127.17	161.32	154.59	179.86	249.69
NASDAQ Bank Index	100.00	81.50	91.18	79.85	92.46	128.43
America's Community Bankers NASDAQ Index	100.00	78.62	85.89	78.59	90.64	126.20

**ITEM 6. SELECTED FINANCIAL DATA**

The following information is derived from the audited consolidated financial statements of the Company. For additional information, reference is made to Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements of the Company and related notes included elsewhere in this Annual Report.

	At and For the Years Ended December 31,				
	2013	2012	2011	2010	2009
(Dollars in thousands, except per share data)					
<b>Selected Financial Condition Data:</b>					
Total assets	\$ 1,453,594	\$ 1,481,192	\$ 1,563,575	\$ 1,530,655	1,566,963
Loans, net	1,098,077	1,030,465	1,227,391	1,050,766	1,218,540
Loans held-for-sale	—	2,166	1,918	2,716	—
Securities, at fair value	110,907	77,832	92,832	120,747	102,126
Goodwill	—	—	—	22,566	22,566
Core deposit intangible	2,433	3,038	3,671	2,700	4,295
Deposits	1,252,708	1,282,351	1,332,552	1,235,377	1,233,395
Borrowings	3,055	5,567	9,322	23,749	50,784
Equity	175,627	172,890	199,857	253,285	263,603
<b>Selected Operating Data:</b>					
Interest and dividend income	\$ 49,392	\$ 60,727	\$ 69,708	\$ 64,936	\$ 74,109
Interest expense	3,653	4,447	6,915	13,186	20,557
Net interest income	45,739	56,280	62,793	51,750	53,552
Provision for (recovery of) loan losses	(687)	31,522	22,723	12,083	8,811
Net interest income after provision for (recovery of) loan losses	46,426	24,758	40,070	39,667	44,741
Noninterest income	8,134	7,723	8,144	7,917	8,022
Noninterest expense <sup>(1)</sup>	51,262	59,590	84,535	54,638	53,514
Income (loss) before income taxes	3,298	(27,109)	(36,321)	(7,054)	(751)
Income tax expense (benefit) <sup>(2)</sup>	—	—	12,375	(2,747)	(13)
Net income (loss)	\$ 3,298	\$ (27,109)	\$ (48,696)	\$ (4,307)	\$ (738)
Basic earnings (loss) per common share	\$ 0.16	\$ (1.36)	\$ (2.46)	\$ (0.22)	\$ (0.04)
Diluted earnings (loss) per common share	\$ 0.16	\$ (1.36)	\$ (2.46)	\$ (0.22)	\$ (0.04)

(footnotes on following page)



**At and For the Years Ended December 31,**

	2013	2012	2011	2010	2009
<b>Selected Financial Ratios and Other Data:</b>					
<b>Performance Ratios:</b>					
Return on assets (ratio of net income (loss) to average total assets)	0.23%	(1.78)%	(3.00)%	(0.28)%	(0.05)%
Return on equity (ratio of net income (loss) to average equity)	1.89	(13.36)	(19.47)	(1.64)	(0.28)
Net interest rate spread <sup>(3)</sup>	3.28	3.86	4.09	3.36	3.36
Net interest margin <sup>(4)</sup>	3.33	3.93	4.20	3.57	3.69
Efficiency ratio <sup>(5)</sup>	95.15	93.11	85.53	91.57	86.91
Noninterest expense to average total assets <sup>(6)</sup>	3.53	3.92	3.74	3.50	3.41
Average interest-earning assets to average interest-bearing liabilities	121.50	123.17	122.68	122.56	123.43
Dividends declared per share	\$ 0.04	\$ 0.03	\$ 0.22	\$ 0.28	\$ 0.28
Dividend payout ratio	25.6%	N.M.	N.M.	N.M.	N.M.
<b>Asset Quality Ratios:</b>					
Nonperforming assets to total assets <sup>(7)</sup>	1.70%	2.61 %	6.33 %	3.99 %	3.43 %
Nonperforming loans to total loans	1.66	2.70	6.08	4.34	4.02
Allowance for loan losses to nonperforming loans	76.89	63.64	41.47	47.69	37.52
Allowance for loan losses to total loans	1.27	1.72	2.52	2.07	1.51
Net charge-offs to average loans outstanding	0.31	3.91	1.04	0.75	0.39
<b>Capital Ratios:</b>					
Equity to total assets at end of period	12.08%	11.67 %	12.78 %	16.55 %	16.82 %
Average equity to average assets	12.05	13.36	15.42	16.77	17.02
Tier 1 leverage ratio (Bank only)	10.16	9.60	10.48	12.48	12.44
<b>Other Data:</b>					
Number of full-service offices <sup>(8)</sup>	20	20	20	18	18
Employees (full-time equivalents)	301	352	357	328	372

(1) Noninterest expense for the year ended December 31, 2011 includes a full goodwill impairment of \$23.9 million. Noninterest expense for the year ended December 31, 2009 includes \$401,000 of impairment loss on securities.

(2) Income tax expense for the year ended December 31, 2011 includes a full valuation allowance for the deferred tax asset of \$22.6 million.

(3) 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.

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

(5) The efficiency ratio represents noninterest expense, less goodwill impairment, divided by the sum of net interest income and noninterest income.

(6) The noninterest expense to average total assets ratio represents noninterest expense less goodwill impairment, divided by average total assets.

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

(8) The Bank's Hyde Park East branch was closed on January 2, 2014.

N.M. Not Meaningful

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The discussion and analysis that follows focuses on the factors affecting our consolidated financial condition at December 31, 2013 and 2012, and our consolidated results of operations for the three years ended December 31, 2013. Our consolidated financial statements, the related notes and the discussion of our critical accounting policies appearing elsewhere in this Annual Report should be read in conjunction with this discussion and analysis.

### Overview of 2013

Total loans increased in 2013 due to increased marketing and deployment of new loan and lease products. Consistent with our practices in previous years, we actively managed our loan portfolio to exit certain multifamily, commercial real estate and commercial loan relationships based on their risk rating. We managed our deposit portfolio to retain higher value core deposit relationships and reduce our cost of funds to the lowest practicable levels. We ended 2013 with our highest-ever core deposit ratio at 78.0% of total deposits and our lowest-ever cost of funds.

We continued to reduce our core noninterest expense in 2013, focusing principally on efficiencies related to staffing, facilities and our ongoing initiatives to utilize technology-based transaction processing and customer information delivery capabilities.

We executed our plan to achieve a material reduction in nonperforming assets and future nonperforming asset expenses during 2013. Our ratio of nonperforming assets to total assets was 1.70% at December 31, 2013. Absent currently unforeseen developments, we expect to achieve our goal of restoring our asset quality to its long-term historical levels by the end of 2014.

### Outlook for 2014

The combined effect of low market interest rates and yields and competitive forces in the Chicago metropolitan area will maintain pressure on asset yields throughout 2014. Continued deployment of excess liquidity through loan growth within our targeted asset classes should enable us to continue to expand our net interest margin gradually in 2014. As we expect the present economic environment in the Chicago metropolitan area to continue for a considerable period of time, we will continue to accelerate the evolution of our loan portfolio towards a configuration that permits better growth rates in multiple, independent segments with comparable risk-adjusted yields.

We expect to release new deposit-related products to improve non-interest income during the course of 2014; in addition, we may also be successful in increasing revenues related to trust, non-deposit wealth management, and commercial property and casualty sales due to new product capabilities and increased dedicated sales capacity. Core non-interest expense is expected to continue to decline despite increases in advertising and marketing expenses related to loan and deposit growth initiatives. Through these actions, we hope to further improve our core operating earnings in 2014 to a level consistent with peer institutions in our market.

### Results of Operation

#### *Net Income*

**Comparison of Year 2013 to 2012.** We recorded net income of \$3.3 million for the year ended December 31, 2013, compared to a net loss of \$27.1 million for 2012. The net loss for 2012 was primarily due to a \$31.5 million provision for loan losses and \$12.7 million of expense for nonperforming asset management and operations of other real estate owned. The \$31.5 million provision for loan losses in 2012 included a \$11.5 million charge relating to the consummation of two bulk loan sales and a \$5.9 million charge relating to the transfer of loans to the held for sale portfolio in preparation for a bulk sale. Our earnings per share of common stock was \$0.16 for the year ended December 31, 2013 per share, compared to loss per share of common stock of \$1.36 for the year ended December 31, 2012.

**Comparison of Year 2012 to 2011.** We recorded a net loss of \$27.1 million for the year ended December 31, 2012, compared to a net loss of \$48.7 million for 2011. The net loss for 2012 was primarily due to a \$31.5 million provision for loan losses and \$12.7 million of expense for nonperforming asset management and operations of other real estate owned. The \$31.5 million provision for loan losses included a \$11.5 million charge relating to the consummation of two bulk loan sales and a \$5.9 million charge relating to the transfer of loans to the held for sale portfolio in preparation for a bulk sale. The net loss in 2011 was primarily due to the recording of a goodwill impairment expense of \$23.9 million, a \$22.6 million valuation allowance for deferred tax assets, a \$22.7 million provision for loan losses and \$10.8 million of expense for nonperforming asset management and operations of other real estate owned. Our loss per share of common stock for the year ended December 31, 2012 was \$1.36 per share, compared to \$2.46 per share for the year ended December 31, 2011.

***Net Interest Income***

Net interest income is our primary source of revenue. Net interest income equals the excess of interest income (including discount accretion on purchased impaired loans) plus fees earned on interest earning assets over interest expense incurred on interest-bearing liabilities. The level of interest rates and the volume and mix of interest-earning assets and interest-bearing liabilities impact net interest income. Interest rate spread and net interest margin are utilized to measure and explain changes in net interest income. Interest rate spread is the difference between the yield on interest-earning assets and the rate paid for interest-bearing liabilities that fund those assets. The net interest margin is expressed as the percentage of net interest income to average interest-earning assets. The net interest margin exceeds the interest rate spread because noninterest-bearing sources of funds, principally noninterest-bearing demand deposits and stockholders' equity, also support interest-earning assets.

The accounting policies underlying the recognition of interest income on loans, securities, and other interest-earning assets are included in Note 1 of "Notes to Consolidated Financial Statements" in Item 8 of this Form 10-K.

## Average Balance Sheets

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

	Years Ended December 31,									
	2013			2012			2011			
	Average Outstanding Balance	Interest	Yield/Rate	Average Outstanding Balance	Interest	Yield/Rate	Average Outstanding Balance	Interest	Yield/Rate	
(Dollars in thousands)										
<b>Interest-earning Assets:</b>										
Loans	\$ 1,031,240	\$ 47,691	4.62%	\$ 1,155,820	\$ 58,716	5.08%	\$ 1,261,704	\$ 66,706	5.29%	
Securities	72,699	981	1.35	80,030	1,485	1.86	106,060	2,665	2.51	
Stock in FHLBC	6,736	22	0.33	10,729	29	0.27	16,243	16	0.10	
Other	262,425	698	0.27	185,963	497	0.27	112,063	321	0.29	
Total interest-earning assets	1,373,100	49,392	3.60	1,432,542	60,727	4.24	1,496,070	69,708	4.66	
Noninterest-earning assets	78,461			86,191			125,937			
Total assets	<u>\$ 1,451,561</u>			<u>\$ 1,518,733</u>			<u>\$ 1,622,007</u>			
<b>Interest-bearing Liabilities:</b>										
Savings deposits	\$ 147,444	152	0.10	\$ 144,684	148	0.10	\$ 135,127	211	0.16	
Money market accounts	343,823	1,169	0.34	346,118	1,262	0.36	350,228	1,593	0.45	
NOW accounts	347,528	379	0.11	335,552	416	0.12	323,295	500	0.15	
Certificates of deposit	288,351	1,939	0.67	328,529	2,517	0.77	398,059	4,389	1.10	
Total deposits	1,127,146	3,639	0.32	1,154,883	4,343	0.38	1,206,709	6,693	0.55	
Borrowings	2,964	14	0.47	8,162	104	1.27	12,758	222	1.74	
Total interest-bearing liabilities	1,130,110	3,653	0.32	1,163,045	4,447	0.38	1,219,467	6,915	0.57	
Noninterest-bearing deposits	129,755			134,807			131,695			
Noninterest-bearing liabilities	16,818			18,036			20,695			
Total liabilities	1,276,683			1,315,888			1,371,857			
Equity	174,878			202,845			250,150			
Total liabilities and equity	<u>\$ 1,451,561</u>			<u>\$ 1,518,733</u>			<u>\$ 1,622,007</u>			
Net interest income		<u>\$ 45,739</u>			<u>\$ 56,280</u>			<u>\$ 62,793</u>		
Net interest rate spread <sup>(1)</sup>			3.28%			3.86%			4.09%	
Net interest-earning assets <sup>(2)</sup>	<u>\$ 242,990</u>			<u>\$ 269,497</u>			<u>\$ 276,603</u>			
Net interest margin <sup>(3)</sup>			3.33%			3.93%			4.20%	
Ratio of interest-earning assets to interest-bearing liabilities	121.50%			123.17%			122.68%			

(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.

**Comparison of Year 2013 to 2012.** Net interest income decreased by \$10.5 million, or 18.7%, to \$45.7 million for the year ended December 31, 2013, from \$56.3 million for the year ended December 31, 2012. Our net interest rate spread decreased 58 basis points to 3.28% for the year ended December 31, 2013, compared to 3.86% for 2012. Our net interest margin decreased by 60 basis points to 3.33% for the year ended December 31, 2013, from 3.93% for 2012. Our average interest-earning assets decreased \$59.4 million to \$1.373 billion for the year ended December 31, 2013, from \$1.433 billion for the year ended 2012, and our average interest-bearing liabilities decreased \$32.9 million to \$1.130 billion for the year ended December 31, 2013, from \$1.163 billion for 2012.

**Comparison of Year 2012 to 2011.** Net interest income decreased by \$6.5 million, or 10.4%, to \$56.3 million for the year ended December 31, 2012, from \$62.8 million for the year ended December 31, 2011. Our net interest rate spread decreased 23 basis points to 3.86% for the year ended December 31, 2012, compared to 4.09% for 2011. Our net interest margin decreased by 27 basis points to 3.93% December 31, 2012 from 4.20% for 2011. Our average interest-earning assets decreased \$63.5 million to \$1.433 billion for the year ended December 31, 2012, from \$1.496 billion for 2011, and our average interest-bearing liabilities decreased \$56.4 million to \$1.163 billion for the year ended December 31, 2012, from \$1.219 billion for 2011.

### Rate/Volume Analysis

The following table presents the dollar amount of changes in interest income and interest expense for the major categories of our interest-earning assets and interest-bearing liabilities. Information is provided for each category of interest-earning assets and interest-bearing liabilities with respect to changes attributable to changes in volume (i.e., changes in average balances multiplied by the prior-period average rate), and changes attributable to rate (i.e., changes in average rate multiplied by prior-period average balances). For purposes of this table, changes attributable to both rate and volume that cannot be segregated have been allocated proportionately to the change due to volume and the change due to rate.

	Years Ended December 31,					
	2013 vs. 2012			2012 vs. 2011		
	Increase (Decrease) Due to		Total Increase (Decrease)	Increase (Decrease) Due to		Total Increase (Decrease)
	Volume	Rate		Volume	Rate	
(Dollars in thousands)						
<b>Interest-earning assets:</b>						
Loans	\$ (5,991)	\$ (5,034)	\$ (11,025)	\$ (5,424)	\$ (2,566)	\$ (7,990)
Securities	(126)	(378)	(504)	(574)	(606)	(1,180)
Stock in FHLBC	(12)	5	(7)	(7)	20	13
Other	201	—	201	200	(24)	176
Total interest-earning assets	(5,928)	(5,407)	(11,335)	(5,805)	(3,176)	(8,981)
<b>Interest-bearing liabilities:</b>						
Savings deposits	4	—	4	16	(79)	(63)
Money market accounts	(10)	(83)	(93)	(18)	(313)	(331)
NOW accounts	9	(46)	(37)	18	(102)	(84)
Certificates of deposit	(280)	(298)	(578)	(689)	(1,183)	(1,872)
Borrowings	(45)	(45)	(90)	(67)	(51)	(118)
Total interest-bearing liabilities	(322)	(472)	(794)	(740)	(1,728)	(2,468)
Change in net interest income	\$ (5,606)	\$ (4,935)	\$ (10,541)	\$ (5,065)	\$ (1,448)	\$ (6,513)

## Provision for Loan Losses

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

We recorded a recovery of loan losses of \$687,000 for the year ended December 31, 2013, compared to a provision for loan losses of \$31.5 million in 2012 and \$22.7 million in 2011. The provision for loan losses is a function of the allowance for loan loss methodology we use to determine the appropriate level of the allowance for inherent loan losses after net charge-offs have been deducted. The portion of the allowance for loan losses attributable to loans collectively evaluated for impairment decreased \$2.6 million, or 15.7%, to \$13.8 million at December 31, 2013, compared to \$16.3 million at December 31, 2012. The primary reason for this decrease is that the growth that occurred in our loan portfolio in 2013 focused on loan types that had lower loss ratios based on our historical loss experience. Net charge-offs were \$3.2 million in 2013, compared to \$45.2 million in 2012 and \$13.2 million in 2011. Net charge-offs for 2012 included a \$10.8 million charge-off relating to compliance with the OCC's regulatory transition guidance concerning the elimination of special valuation allowances, as well as a \$17.4 million charge relating to the consummation of two bulk loan sales and the transfer of loans to the held for sale portfolio in preparation for a bulk sale. For further analysis and information on how we determine the appropriate level for the allowance for loan losses and analysis of credit quality, see "Critical Accounting Policies" and "Risk Classification of Loans and Allowance for Loan Losses."

## Noninterest Income

	Years Ended December 31,			Change	
	2013	2012	2011	2013 vs. 2012	2012 vs. 2011
	(Dollars in thousands)				
Deposit service charges and fees	\$ 2,005	\$ 2,176	\$ 2,667	\$ (171)	\$ (491)
Other fee income	2,250	2,393	2,425	(143)	(32)
Insurance commissions and annuities income	474	510	659	(36)	(149)
Gain on sale of loans, net	1,469	841	340	628	501
Loss on disposition of premises and equipment	(43)	(156)	(19)	113	(137)
Loan servicing fees	461	486	538	(25)	(52)
Amortization of servicing assets	(233)	(265)	(252)	32	(13)
Recovery (impairment) of servicing assets	65	(55)	(15)	120	(40)
Earnings on bank owned life insurance	313	438	626	(125)	(188)
Trust income	711	733	676	(22)	57
Other	662	622	499	40	123
<b>Total noninterest income</b>	<b>\$ 8,134</b>	<b>\$ 7,723</b>	<b>\$ 8,144</b>	<b>\$ 411</b>	<b>\$ (421)</b>

**Comparison of Year 2013 to 2012.** Our noninterest income increased by \$411,000 to \$8.1 million for the year ended December 31, 2013, from \$7.7 million for the year ended December 31, 2012. Noninterest income for the year ended December 31, 2013 included a \$1.5 million gain on sale of loans, which included recurring loan sale activity combined with the completion of the sale of the owner-occupied and investor-owned one-to four family residential loans that we designated as held for sale at December 31, 2012. The completion of this sale represented approximately \$1.3 million of the \$1.5 million gain on sale of loans that we recorded for the year ended December 31, 2013. We recorded a recovery of an impairment of servicing assets of \$65,000 for the year ended December 31, 2013, compared to an impairment of \$55,000 in 2012. Bank-owned life insurance produced earnings of \$313,000 for 2013, a decrease of \$125,000, or 28.5%, compared to a \$438,000 for 2012 due to decreased annualized policy returns.

**Comparison of Year 2012 to 2011.** Our noninterest income decreased by \$421,000 to \$7.7 million for the year ended December 31, 2012, from \$8.1 million for the year ended December 31, 2011. Factors affecting the change in noninterest income included a \$491,000, or 18.4%, decrease in deposit service charges and fees to \$2.2 million, from \$2.7 million for 2011, primarily attributable to the impact that the Dodd-Frank Act had on certain deposit service charges and fees. Bank-owned life insurance produced earnings of \$438,000 for the year ended December 31, 2012, a decrease of \$188,000, or 30.0%, compared to a \$626,000 for 2011.

## Noninterest Expense

	Years Ended December 31,			Change	
	2013	2012	2011	2013 vs. 2012	2012 vs. 2011
	(Dollars in thousands)				
Compensation and benefits	\$ 26,195	\$ 25,791	\$ 26,106	\$ 404	\$ (315)
Office occupancy and equipment	7,547	8,060	8,541	(513)	(481)
Advertising and public relations	925	733	895	192	(162)
Information technology	3,091	3,062	2,775	29	287
Supplies, telephone and postage	1,697	1,840	1,829	(143)	11
Amortization of intangibles	605	633	1,689	(28)	(1,056)
Nonperforming asset management	2,638	5,211	4,431	(2,573)	780
Loss on sale other real estate owned	148	252	15	(104)	237
Valuation adjustments of other real estate owned	550	5,560	3,970	(5,010)	1,590
Operations of other real estate owned	915	1,679	2,350	(764)	(671)
FDIC insurance premiums	1,913	1,779	1,441	134	338
Acquisition costs	—	—	1,761	—	(1,761)
Goodwill impairment	—	—	23,862	—	(23,862)
Other	5,038	4,990	4,870	48	120
<b>Total noninterest expense</b>	<b>\$ 51,262</b>	<b>\$ 59,590</b>	<b>\$ 84,535</b>	<b>\$ (8,328)</b>	<b>\$ (24,945)</b>

**Comparison of Year 2013 to 2012.** For the year ended December 31, 2013, noninterest expense decreased by \$8.3 million, or 14.0%, to \$51.3 million, from \$59.6 million for 2012. Compensation and benefits expense included \$175,000 in severance expense for the year ended December 31, 2013, compared to \$147,000 for 2012. Loan-related incentive compensation was \$500,000 for the year ended December 31, 2013, compared to \$187,000 for the year ended December 31, 2012. Stock-based compensation for the year ended December 31, 2013 was \$933,000, an increase of \$206,000, or 28.3%, compared to \$727,000 for the year ended December 31, 2012. This increase is a result of 2013 restricted stock grants combined with increased ESOP expense as a result of a higher stock price at year end. Noninterest expense for 2013 included \$4.3 million of nonperforming asset management and OREO expenses, compared to \$12.7 million for 2012. Nonperforming asset management expenses decreased \$2.6 million to \$2.6 million for the year ended December 31, 2013, compared to \$5.2 million in 2012. OREO expenses for the year ended December 31, 2013 included a \$550,000 valuation adjustment to OREO properties compared to a \$5.6 million valuation adjustment in 2012. Other noninterest expense for the year ended December 31, 2013 included the payment of \$203,000 of settlements concerning two sold mortgage loans. Other noninterest expense for the year ended December 31, 2013 also included a provision of \$118,000 for the establishment of a mortgage representation and warranty reserve for mortgage loans sold. The amount of the representation and warranty reserve was calculated by applying published Fannie Mae data relating to the percentage of loans that it required to be repurchased due to breaches of representations and warranties to the Bank's outstanding sold loans.

**Comparison of Year 2012 to 2011.** For the year ended December 31, 2012, noninterest expense decreased by \$24.9 million, or 29.5%, to \$59.6 million from \$84.5 million for 2011. The decrease was primarily due to the recording of a \$23.9 million goodwill impairment expense in 2011, increased nonperforming asset management and OREO operations expenses, and expenses recorded in connection with acquisitions. Noninterest expense for 2012 included \$12.7 million of nonperforming asset management and OREO expenses, compared to \$10.8 million for 2011. OREO expenses for the year ended December 31, 2012 included a \$5.6 million valuation adjustment to OREO properties compared to a \$4.0 million valuation adjustment in 2011. The increase in valuation adjustments was due in part to a revision of our disposition strategy for certain income-producing OREO properties from an ordinary-liquidation pricing model to an aggressive pricing model designed to stimulate market demand. Acquisition expenses reflected a \$1.4 million expense relating to the acquisition of Downers Grove National Bank, including \$518,000 for data processing contracts and operational expenses and \$675,000 contract and severance payments, and a \$396,000 expense relating to our Chicago area multi-family loan purchase from Citibank.

## Income Taxes

**Comparison of Year 2013 to 2012.** For the years ended December 31, 2013 and 2012, we recorded no income tax expense or benefit due to the full valuation allowance we established for deferred tax assets.

**Comparison of Year 2012 to 2011.** For the year ended December 31, 2012 we recorded no income tax expense or benefit due to the full valuation allowance we established for deferred tax assets. The recognition of the \$12.4 million income tax expense for the year ended December 31, 2011 resulted from a non-cash charge of \$22.6 million for the establishment of a full valuation allowance for our deferred tax assets.

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

Total assets decreased \$27.6 million, or 1.9%, to \$1.454 billion at December 31, 2013, from \$1.481 billion at December 31, 2012. The decrease in total assets was primarily due to a decrease in cash and cash equivalents, other real estate owned, and FDIC prepaid insurance, which was partially offset by increases in loans receivable and securities. Net loans increased \$67.6 million to \$1.098 billion at December 31, 2013, from \$1.030 billion at December 31, 2012. Net cash and cash equivalents decreased by \$114.8 million to \$161.0 million at December 31, 2013, from \$275.8 million at December 31, 2012. In December 2012, we designated certain owner-occupied and investor-owned one-to-four family residential loans with a carrying value of \$7.5 million as “held for sale” in preparation for a bulk sale. The bulk sale of these one-to-four family residential loans was completed in February 2013.

Our loan portfolio consists primarily of investment and business loans (multi-family, nonresidential real estate, commercial, construction and land loans, and commercial leases), which together made up 81.7% of gross loans at December 31, 2013. Net loans receivable increased \$67.6 million, or 6.6%, to \$1.098 billion at December 31, 2013. Multi-family mortgage loans increased by \$44.0 million, or 12.5%; commercial loans decreased by \$7.1 million, or 11.6%; nonresidential real estate loans decreased \$1.1 million, or 0.4%; construction and land loans decreased \$2.0 million, or 23.2%. One-to-four family residential mortgage loans decreased \$17.2 million, or 7.9%. Commercial leases increased by \$47.3 million, or 33.9%.

Our allowance for loan losses decreased by \$3.9 million, or 21.5%, to \$14.2 million at December 31, 2013, from \$18.0 million at December 31, 2012. The decrease reflected the combined impact of a \$687,000 recovery of loan losses and \$3.2 million in net charge-offs. Net charge-offs for 2012 included a \$10.8 million charge-off relating to compliance with the OCC's regulatory transition guidance concerning the elimination of special valuation allowances.

Securities increased \$33.1 million, or 42.5%, to \$110.9 million at December 31, 2013, from \$77.8 million at December 31, 2012, due primarily to the purchase of \$74.2 million of securities partially offset by the receipt of principal repayments of \$13.5 million on residential mortgage-backed and collateralized mortgage obligations. During 2013 and 2012, we also invested in FDIC insured certificates of deposit issued by other insured depository institutions.

Deposits decreased \$29.6 million, or 2.3%, to \$1.253 billion at December 31, 2013, from \$1.282 billion at December 31, 2012, due to a decrease in certificates of deposits. Core deposits (savings, money market, noninterest-bearing demand and NOW accounts) increased as a percentage of total deposits, representing 78.0% of total deposits at December 31, 2013, compared to 76.2% of total deposits at December 31, 2012.

Certificates of deposit decreased \$29.6 million, or 9.7%, to \$275.6 million at December 31, 2013 from \$305.3 million at December 31, 2012. The decrease was primarily due to a lessening of our competitive pricing position in anticipation of additional excess liquidity resulting from loan payments and bulk sales of loans.

Total stockholders' equity was \$175.6 million at December 31, 2013, compared to \$172.9 million at December 31, 2012. The increase in total stockholders' equity was primarily due to \$3.3 million of net income that we recorded for the year ended December 31, 2013, which was partially offset by the \$844,000 in dividends that were paid to our stockholders. The unallocated shares of common stock that our ESOP owns were reflected as a \$11.3 million reduction to stockholders' equity at December 31, 2013, compared to \$12.2 million at December 31, 2012.

### **Securities**

Our investment policy is established by our Board of Directors. The policy emphasizes safety of the investment, liquidity requirements, potential returns, cash flow targets, and consistency with our interest rate risk management strategy.

At December 31, 2013, our mortgage-backed securities and collateralized mortgage obligations (“CMOs”) reflected in the following table were issued by U.S. government-sponsored enterprises and agencies, Freddie Mac, Fannie Mae and Ginnie Mae, and are obligations which the federal government has affirmed its commitment to support. All securities reflected in the table were classified as available-for-sale at December 31, 2013, 2012 and 2011.

We hold FHLBC common stock to qualify for membership in the Federal Home Loan Bank System and to be eligible to borrow funds under the FHLBC's advance program. The aggregate cost of our FHLBC common stock as of December 31, 2013 was \$6.1 million based on its par value. There is no market for FHLBC common stock. Due to our receipt of stock dividends in prior years



and the amount of our outstanding FHLBC advances, we owned more shares of FHLBC common stock than we were required to own to maintain our membership in the Federal Home Loan Bank System and to be eligible to obtain advances (“excess” or “voluntary” capital stock). We redeemed \$2.3 million and \$7.9 million of excess FHLBC stock during 2013 and 2012, respectively. At December 31, 2013 we owned no excess shares of FHLBC common stock.

The following table sets forth the composition, amortized cost and fair value of our securities.

	At December 31,					
	2013		2012		2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)					
<b>Securities:</b>						
Certificates of deposits	\$ 65,010	\$ 65,010	\$ 33,456	\$ 33,456	\$ 30,448	\$ 30,448
Municipal securities	180	187	350	369	515	551
Equity mutual fund	500	497	500	528	500	524
SBA - guaranteed loan participation certificates	35	35	42	42	47	47
Total	65,725	65,729	34,348	34,395	31,510	31,570
<b>Mortgage-backed Securities:</b>						
Mortgage-backed securities - residential	27,229	28,364	32,572	34,233	34,691	36,076
CMOs and REMICs - residential	16,851	16,814	9,111	9,204	24,837	25,186
Total mortgage-backed securities	44,080	45,178	41,683	43,437	59,528	61,262
	<u>\$ 109,805</u>	<u>\$ 110,907</u>	<u>\$ 76,031</u>	<u>\$ 77,832</u>	<u>\$ 91,038</u>	<u>\$ 92,832</u>

The fair values of marketable equity securities are generally determined by quoted prices, in active markets, for each specific security. If quoted market prices are not available for a marketable equity security, we determine its fair value based on the quoted price of a similar security traded in an active market. The fair values of debt securities are generally determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities’ relationship to other benchmark quoted securities. The fair value of a security is used to determine the amount of any unrealized losses that must be reflected in our other comprehensive income and the net book value of our securities.

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

**Portfolio Maturities and Yields**

The composition and maturities of the securities portfolio and the mortgage-backed securities portfolio at December 31, 2013 are summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur. Municipal securities yields have not been adjusted to a tax-equivalent basis, as the amount is immaterial.

	One Year or Less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
(Dollars in thousands)								
<b>Securities:</b>								
Certificates of deposit	\$ 65,010	0.53%	\$ —	—%	\$ —	—%	\$ —	—%
Municipal securities	180	4.60	—	—	—	—	—	—
Equity mutual fund	500	1.85	—	—	—	—	—	—
SBA guaranteed loan participation certificates	—	—	—	—	35	1.75	—	—
	65,690	0.55	—	—	35	1.75	—	—
<b>Mortgage-backed Securities:</b>								
Pass-through securities:								
Fannie Mae	—	—	899	5.68	13	2.30	11,916	2.92
Freddie Mac	—	—	105	1.68	129	2.28	1,571	3.39
Ginnie Mae	—	—	—	—	104	1.63	12,492	2.57
CMOs and REMICs	—	—	—	—	251	1.74	16,600	0.68
	—	—	1,004	5.26	497	1.87	42,579	1.96
Total securities	\$ 65,690	0.55%	\$ 1,004	5.26%	\$ 532	1.86%	\$ 42,579	1.96%

## Loan Portfolio

We originate multi-family mortgage loans, nonresidential real estate loans, commercial loans, commercial leases, and construction and land loans. In addition, we originate one-to-four family residential mortgage loans and consumer loans, and purchase and sell loan participations from time-to-time. Our principal loan products are discussed in Note 4 of the "Notes to Consolidated Financial Statements" in Item 8 of this Form 10-K.

The following table sets forth the composition of our loan portfolio, excluding loans held-for-sale, by type of loan.

At December 31,										
2013		2012		2011		2010		2009		
Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	
(Dollars in thousands)										
One-to-four family residential	\$ 201,382	18.12%	\$ 218,596	20.86%	\$ 272,032	21.62%	\$ 256,300	23.92%	\$ 289,623	23.44%
Multi-family mortgage	396,058	35.64	352,019	33.60	423,615	33.67	296,916	27.71	329,227	26.65
Nonresidential real estate	263,567	23.72	264,672	25.26	311,641	24.77	281,987	26.31	316,607	25.62
Construction and land	6,570	0.59	8,552	0.82	19,852	1.58	18,398	1.72	32,577	2.64
Commercial loans	54,255	4.88	61,388	5.86	93,932	7.46	64,679	6.04	88,067	7.13
Commercial leases	187,112	16.84	139,783	13.34	134,990	10.73	151,107	14.10	176,821	14.31
Consumer	2,317	0.21	2,745	0.26	2,147	0.17	2,182	0.20	2,539	0.21
	<u>1,111,261</u>	<u>100.00%</u>	<u>1,047,755</u>	<u>100.00%</u>	<u>1,258,209</u>	<u>100.00%</u>	<u>1,071,569</u>	<u>100.00%</u>	<u>1,235,461</u>	<u>100.00%</u>
Net deferred loan origination costs	970		745		908		1,377		1,701	
Allowance for loan losses	(14,154)		(18,035)		(31,726)		(22,180)		(18,622)	
Total loans, net	<u>\$ 1,098,077</u>		<u>\$ 1,030,465</u>		<u>\$ 1,227,391</u>		<u>\$ 1,050,766</u>		<u>\$ 1,218,540</u>	

## Loan Portfolio Maturities

The following table summarizes the scheduled repayments of our loan portfolio at December 31, 2013. Demand loans, loans having no stated repayment schedule or maturity and overdraft loans are reported as being due in one year or less.

	Within One Year	One Year Through Five Years	Beyond Five Years	Total
(Dollars in thousands)				
<b>Scheduled Repayments of Loans:</b>				
One-to-four family residential	\$ 28,197	\$ 65,452	\$ 107,733	\$ 201,382
Multi-family mortgage	34,888	130,443	230,727	396,058
Nonresidential real estate	96,196	151,686	15,685	263,567
Construction and land	5,449	1,121	—	6,570
Commercial loans and leases	123,756	114,216	3,395	241,367
Consumer	582	1,274	461	2,317
	<u>\$ 289,068</u>	<u>\$ 464,192</u>	<u>\$ 358,001</u>	<u>\$ 1,111,261</u>
				<b>Total</b>
<b>Loans Maturing After One Year:</b>				
Predetermined (fixed) interest rates			\$ 601,268	
Adjustable interest rates			220,925	
			<u>\$ 822,193</u>	

## Nonperforming Loans and Assets

We review loans on a regular basis, and generally place loans on nonaccrual status when either principal or interest is 90 days or more past due. In addition, the Company places loans on nonaccrual status when we do not expect to receive full payment of interest or principal. Interest accrued and unpaid at the time a loan is placed on nonaccrual status is reversed from interest income. Interest payments received on nonaccrual loans are recognized in accordance with our significant accounting policies. Once a loan is placed on nonaccrual status, the borrower must generally demonstrate at least six months of payment performance before the loan is eligible to return to accrual status. We may have loans classified as 90 days or more delinquent and still accruing. Generally, we do not utilize this category of loan classification unless: (1) the loan is repaid in full shortly after the period end date; (2) the loan is well secured and there are no asserted or pending legal barriers to its collection; or (3) the borrower has remitted all scheduled payments and is otherwise in substantial compliance with the terms of the loan, but the processing of loan payments actually received or the renewal of the loan has not occurred for administrative reasons. At December 31, 2013, we had one loan totaling \$228,000 in this category.

We typically obtain new third-party appraisals or collateral valuations when we place a loan on nonaccrual status, conduct impairment testing or complete a TDR unless the existing valuation information for the collateral is sufficiently current to comply with the requirements of our Appraisal and Collateral Valuation Policy (“ACV Policy”). We also obtain new third-party appraisals or collateral valuations when the judicial foreclosure process concludes with respect to real estate collateral, and when we otherwise acquire actual or constructive title to real estate collateral. In addition to third-party appraisals, we use updated valuation information based on Multiple Listing Service data, broker opinions of value, actual sales prices of similar assets sold by us and approved sales prices in response to offers to purchase similar assets owned by us to provide interim valuation information for consolidated financial statement and management purposes. Our ACV Policy establishes the maximum useful life of a real estate appraisal at 18 months. Because appraisals and updated valuations utilize historical or “ask-side” data in reaching valuation conclusions, the appraised or updated valuation may or may not reflect the actual sales price that we will receive at the time of sale.

Real estate appraisals may include up to three approaches to value: the sales comparison approach, the income approach (for income-producing property) and the cost approach. Not all appraisals utilize all three approaches. Depending on the nature of the collateral and market conditions, we may emphasize one approach over another in determining the fair value of real estate collateral. Appraisals may also contain different estimates of value based on the level of occupancy or planned future improvements. “As-is” valuations represent an estimate of value based on current market conditions with no changes to the use or condition of the real estate collateral. “As-stabilized” or “as-completed” valuations assume the real estate collateral will be improved to a stated standard or achieve its highest and best use in terms of occupancy. “As-stabilized” or “as-completed” valuations may be subject to a present value adjustment for market conditions or the schedule of improvements.

As part of the asset classification process, we develop an exit strategy for real estate collateral or OREO by assessing overall market conditions, the current use and condition of the asset, and its highest and best use. For most income-producing real estate, we believe that investors value most highly a stable income stream from the asset; consequently, we perform a comparative evaluation to determine whether conducting a sale on an “as-is”, “as-stabilized” or “as-improved” basis is most likely to produce the highest net realizable value. If we determine that the “as-stabilized” or “as-improved” basis is appropriate, we then complete the necessary improvements or tenant stabilization tasks, with the applicable time value discount and improvement expenses incorporated into our estimates of the expected costs to sell. As of December 31, 2013, substantially all impaired real estate loan collateral and OREO were valued on an “as-is basis.”

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

## Nonperforming Assets Summary

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

	At December 31,				
	2013	2012	2011	2010	2009
(Dollars in thousands)					
<b>Nonaccrual loans</b>					
One-to-four family residential	\$ 4,641	\$ 7,299	\$ 10,622	\$ 10,059	\$ 11,453
Multi-family mortgage	7,098	3,517	14,807	13,228	13,961
Nonresidential real estate	4,214	8,985	29,927	12,428	11,074
Construction and land	382	2,210	3,246	6,139	8,841
Commercial	77	256	2,920	3,766	4,160
Commercial leases	—	—	22	72	—
Consumer	12	—	3	3	—
	<u>16,424</u>	<u>22,267</u>	<u>61,547</u>	<u>45,695</u>	<u>49,489</u>
Loans Past Due Over 90 Days, still accruing	228	329	350	818	148
Loans held-for-sale	—	1,752	—	—	—
<b>Other real estate owned</b>					
One-to-four family residential	901	1,760	5,328	3,015	601
Multi-family mortgage	1,921	720	3,655	2,486	976
Nonresidential real estate	1,181	3,504	4,905	7,376	1,416
Land	275	1,323	2,237	1,745	1,091
	<u>4,278</u>	<u>7,307</u>	<u>16,125</u>	<u>14,622</u>	<u>4,084</u>
Nonperforming assets (excluding purchased impaired loans and purchased other real estate owned)	20,930	31,655	78,022	61,135	53,721
<b>Purchased impaired loans</b>					
One-to-four family residential	100	380	3,941	—	—
Multi-family mortgage	—	—	1,418	—	—
Nonresidential real estate	1,633	2,568	3,375	—	—
Construction and land	—	1,021	4,788	—	—
Commercial	23	20	1,078	—	—
	<u>1,756</u>	<u>3,989</u>	<u>14,600</u>	<u>—</u>	<u>—</u>
<b>Purchased other real estate owned</b>					
One-to-four family residential	176	320	327	—	—
Nonresidential real estate	—	462	2,546	—	—
Land	1,852	2,269	3,482	—	—
	<u>2,028</u>	<u>3,051</u>	<u>6,355</u>	<u>—</u>	<u>—</u>
Purchased impaired loans and other real estate owned	3,784	7,040	20,955	—	—
<b>Total nonperforming assets</b>	<u>\$ 24,714</u>	<u>\$ 38,695</u>	<u>\$ 98,977</u>	<u>\$ 61,135</u>	<u>\$ 53,721</u>
<b>Ratios</b>					
Nonperforming loans to total loans	1.66%	2.70%	6.08%	4.34%	4.02%
Nonperforming loans to total loans <sup>(1)</sup>	1.50	2.32	4.92	4.34	4.02
Nonperforming assets to total assets	1.70	2.61	6.33	3.99	3.43
Nonperforming assets to total assets <sup>(1)</sup>	1.44	2.14	4.99	3.99	3.43

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

**Nonperforming Assets**

Nonperforming assets decreased by \$14.0 million in 2013, due in substantial part to the execution of the Company's plan to materially reduce future nonperforming asset expenses and accelerate the return to the Company's historical asset quality levels. Nonperforming assets totaled \$24.7 million at December 31, 2013 and \$38.7 million at December 31, 2012. The decrease in nonperforming assets for the year ended December 31, 2013 reflected the disposition of \$9.0 million in OREO, the disposition of the \$1.7 million of one-to-four family mortgage loans that we designated as held for sale in the fourth quarter of 2012, and numerous other nonperforming asset resolutions. These actions were partially offset by the placement of \$17.9 million of loans on nonaccrual status during the year ended December 31, 2013. The number of loans placed on nonaccrual status in 2013 was impacted by a decision we made in the fourth quarter of 2012 to take affirmative steps to accelerate the resolution of certain performing classified and nonperforming multi-family and nonresidential real estate loans. Specifically, we determined that for certain performing classified and nonperforming multi-family and nonresidential real estate loans, the most cost-effective and expeditious resolution method was to decline to renew the loans upon maturity, or to utilize other remedies provided by our loan documents to accelerate the maturity date of the loans, coupled with an attempt, in appropriate cases, to negotiate a final resolution in the form of a deed-in-lieu of foreclosure. Of the \$17.9 million in loans placed on nonaccrual in 2013, \$9.0 million related to affirmative expedited resolution cases. Of this amount, \$7.4 million involved multi-family loans to ten unaffiliated borrowers. We are pursuing various actions to attempt to obtain title to these multi-family properties so that they can be marketed for sale.

**Other Real Estate Owned**

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

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

	<b>At and For the Years Ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(Dollars in thousands)</b>	
Beginning balance	\$ 10,358	\$ 22,480
New foreclosed properties	5,512	7,035
Valuation adjustments	(578)	(5,750)
Sales	(8,986)	(13,407)
Ending balance	\$ 6,306	\$ 10,358

	December 31, 2013			December 31, 2012		
	Balance	Valuation Allowance	Net OREO Balance	Balance	Valuation Allowance	Net OREO Balance
(Dollars in thousands)						
One-to-four family residential	\$ 1,011	\$ (110)	\$ 901	\$ 1,827	\$ (67)	\$ 1,760
Multi-family mortgage	1,921	—	1,921	720	—	720
Nonresidential real estate	1,455	(274)	1,181	3,883	(379)	3,504
Land	416	(141)	275	1,557	(234)	1,323
	<u>4,803</u>	<u>(525)</u>	<u>4,278</u>	<u>7,987</u>	<u>(680)</u>	<u>7,307</u>
Acquired other real estate owned:						
One-to-four family residential	180	(4)	176	320	—	320
Nonresidential real estate	—	—	—	565	(103)	462
Land	2,225	(373)	1,852	2,666	(397)	2,269
	<u>2,405</u>	<u>(377)</u>	<u>2,028</u>	<u>3,551</u>	<u>(500)</u>	<u>3,051</u>
<b>Total other real estate owned</b>	<u>\$ 7,208</u>	<u>\$ (902)</u>	<u>\$ 6,306</u>	<u>\$ 11,538</u>	<u>\$ (1,180)</u>	<u>\$ 10,358</u>

Activity in the valuation allowance:

	At and For the Years Ended December 31,	
	2013	2012
(Dollars in thousands)		
Beginning of year	\$ 1,180	\$ —
Additions charged to expense	550	1,180
Recoveries credited to expense	—	—
Reductions from sales of other real estate owned	(828)	—
Direct write downs	—	—
End of year	<u>\$ 902</u>	<u>\$ 1,180</u>

#### Loan Extensions and Modifications

Maturing loans are subject to our standard loan underwriting policies and practices. Due to the need to obtain updated borrower and guarantor financial information, collateral information or to prepare revised loan documentations, loans in the process of renewal may appear as past due because the information needed to underwrite a renewal of the loan is not available to us prior to the maturity date of the loan. At times, short-term administrative extensions, which are typically 90 days in duration, are granted to facilitate proper underwriting. In general, loan modifications are subject to a risk-adjusted pricing analysis.

When appropriate, we evaluate loan extensions or modifications in accordance with ASC 310-40 and related federal regulatory guidance concerning TDRs and the FFIEC workout guidance to determine the required treatment for nonaccrual status and risk classification purposes. In general, if we grant a loan modification or extension that involves either the absence of principal amortization (other than for revolving lines of credit which are customarily granted on interest-only terms), or if we grant a material extension of an existing loan amortization period in excess of our underwriting standards, the loan will be placed on nonaccrual status and impairment testing conducted to determine whether a specific valuation allowance or loss classification / charge-off is required. If the loan is well secured by an abundance of collateral and the collectability of both interest and principal is probable, the loan may remain on accrual status, but it will be classified as a TDR due to the concession made in the loan principal amortization payment component. A loan in full compliance with the payment requirements specified in a loan modification will not be considered as past due, but may nonetheless be placed on nonaccrual status or be classified as a TDR, as appropriate under the circumstances.

In accordance with the FFIEC workout guidance, the Company will restructure a note into two separate notes (A/B structure), charging off the entire B portion of the note. The A note is structured with appropriate loan-to-value and cash flow coverage ratios

that provide for a high likelihood of repayment. The A note is classified as a non-performing note until the borrower has displayed a historical payment performance for a reasonable time prior to and subsequent to the restructuring. A period of sustained repayment for at least six months generally is required to return the note to accrual status provided that management has determined that the performance is reasonably expected to continue. The A note will be classified as a restructured note (either performing or nonperforming) through the calendar year of the restructuring that the historical payment performance has been established.

### Troubled Debt Restructurings

The Company had \$3.3 million of TDRs at December 31, 2013, compared to \$11.2 million at December 31, 2012, with \$53,000 and \$318,000 in specific valuation allowances allocated to those loans at December 31, 2013 and 2012, respectively. The Company had no outstanding commitments to borrowers whose loans are classified as TDRs.

The following table presents TDRs by class.

	At December 31,	
	2013	2012
	(Dollars in thousands)	
One-to-four family residential real estate	\$ 2,093	\$ 2,802
Multi-family mortgage	518	1,201
Nonresidential real estate	—	5,189
Accrual troubled debt restructured loans	2,611	9,192
One-to-four family residential real estate	342	767
Multi-family mortgage	384	938
Nonresidential real estate	—	270
Nonaccrual troubled debt restructured loans	726	1,975
Total troubled debt restructured loans	\$ 3,337	\$ 11,167

### Risk Classification of Loans

Our policies, consistent with regulatory guidelines, provide for the classification of loans and other assets that are considered to be of lesser quality as substandard, doubtful, or loss assets, or designated as special mention.

A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. The risk rating guidance published by the OCC clarifies that a loan with a well-defined weakness does not have to present a probability of default for the loan to be rated substandard, and that an individual loan's loss potential does not have to be distinct for the loan to be rated substandard. An asset classified as doubtful has all the weaknesses inherent in one classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets is not warranted; such balances are promptly charged-off as required by applicable federal regulations. A special mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Based on a review of our assets at December 31, 2013, classified loans consisted of \$23.4 million performing substandard loans and \$18.1 million of nonperforming loans. As of December 31, 2013, we had \$15.8 million of assets designated as special mention.

### Allowance for Loan Losses

We establish provisions for loan losses, which are charged to operations in order to maintain the allowance for loan losses at a level we consider necessary to absorb probable incurred credit losses in the loan portfolio. In determining the level of the allowance for loan losses, we consider past and current loss experience, trends in nonaccrual loans, evaluations of real estate collateral, current economic conditions, volume and type of lending, adverse situations that may affect a borrower's ability to repay a loan and the



levels of nonperforming and other classified loans. The amount of the allowance is based on estimates and the ultimate losses may vary from the estimates as more information becomes available or events change.

We provide for loan losses based on the allowance method. Accordingly, all loan losses are charged to the related allowance and all recoveries are credited to it. Additions to the allowance for loan losses are provided by charges to income based on various factors that, in our judgment, deserve current recognition in estimating probable incurred credit losses. We review the loan portfolio on an ongoing basis and make provisions for loan losses on a quarterly basis to maintain the allowance for loan losses in accordance with accounting principles generally accepted in the United States of America. The allowance for loan losses consists of two components:

- specific allowances established for any impaired residential non-owner occupied mortgage, multi-family mortgage, nonresidential real estate, construction and land, commercial, and commercial lease loans for which the recorded investment in the loan exceeds the measured value of the loan; and
- general allowances for loan losses for each loan class based on historical loan loss experience; and adjustments to historical loss experience (general allowances), maintained to cover uncertainties that affect our estimate of probable incurred credit losses for each loan class.

The adjustments to historical loss experience are based on our evaluation of several factors, including levels of, and trends in, past due and classified loans; levels of, and trends in, charge-offs and recoveries; trends in volume and terms of loans, including any credit concentrations in the loan portfolio; experience, ability, and depth of lending management and other relevant staff; and national and local economic trends and conditions.

We evaluate the allowance for loan losses based upon the combined total of the specific and general components. Generally, when the loan portfolio increases, absent other factors, the allowance for loan loss methodology results in a higher dollar amount of estimated probable incurred credit losses than would be the case without the increase. Conversely, when the loan portfolio decreases, absent other factors, the allowance for loan loss methodology generally results in a lower dollar amount of estimated probable losses than would be the case without the decrease.

We review our loan portfolio on an ongoing basis to determine whether any loans require classification and impairment testing in accordance with applicable regulations and accounting principles. When we classify loans as either substandard or doubtful and in certain other cases, we review the collateral and future cash flow projections to determine if a specific reserve is necessary. The allowance for loan losses represents amounts that have been established to recognize incurred credit losses in the loan portfolio that are both probable and reasonably estimable at the date of the consolidated financial statements. When we classify problem loans as loss, we charge-off such amounts.

We refined the calculation of the general component of the allowance for loan losses during the fourth quarter of 2010 in response to the new FASB disclosure requirement that each loan portfolio category must be segmented into specific loan classes (FASB Standards Update 2010-20 (ASU 210-20), "Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses"). Loan class segmentation tables are presented in Note 4 of the "Notes to Consolidated Financial Statements" in Item 8 of this Form 10-K. To maintain consistency, the loan class segmentation was also applied within the 12-quarter loss history that we use to calculate the general component of the allowance for loan losses, inherent risk factor weightings were adjusted based on our evaluation of their relevance to the new loan classes, and duplicative historical loss factors were eliminated from the loan class segmentation.

While we use the best information available to make evaluations, future adjustments to the allowance may become necessary if conditions differ substantially from the information that we used in making the evaluations. Our determinations as to the risk classification of our loans and the amount of our allowance for loan losses are subject to review by our regulatory agencies, which can require that we establish additional loss allowances.

## Net Charge-offs and Recoveries

The following table sets forth activity in our allowance for loan losses.

	At or For the Years Ended December 31,				
	2013	2012	2011	2010	2009
	(Dollars in thousands)				
Balance at beginning of year	\$ 18,035	\$ 31,726	\$ 22,180	\$ 18,622	\$ 14,746
<b>Charge-offs</b>					
One-to-four family residential	(1,505)	(12,366)	(5,316)	(2,292)	(461)
Multi-family mortgage	(1,832)	(7,203)	(3,514)	(2,385)	(297)
Nonresidential real estate	(577)	(18,167)	(698)	(2,897)	(1,518)
Construction and land	(943)	(4,311)	(2,519)	(525)	(2,262)
Commercial loans	(425)	(4,960)	(1,394)	(1,174)	(463)
Commercial leases	—	(121)	(72)	—	(22)
Consumer	(55)	(103)	(93)	(16)	(42)
	(5,337)	(47,231)	(13,606)	(9,289)	(5,065)
<b>Recoveries</b>					
One-to-four family residential	447	233	51	69	82
Multi-family mortgage	236	539	125	3	—
Nonresidential real estate	519	328	73	633	36
Construction and land	463	250	—	58	—
Commercial loans	470	626	173	1	3
Commercial leases	—	—	—	—	6
Consumer	8	42	7	—	3
	2,143	2,018	429	764	130
Net charge-offs	(3,194)	(45,213)	(13,177)	(8,525)	(4,935)
Provision for (recovery of) loan losses	(687)	31,522	22,723	12,083	8,811
Balance at end of year	\$ 14,154	\$ 18,035	\$ 31,726	\$ 22,180	\$ 18,622
<b>Ratios</b>					
Net charge-offs to average loans outstanding	0.31%	3.91%	1.04%	0.75%	0.39%
Allowance for loan losses to nonperforming loans	76.89	63.64	41.47	47.69	37.52
Allowance for loan losses to total loans	1.27	1.72	2.52	2.07	1.51

Our allowance for loan losses decreased \$3.9 million, or 21.5%, in 2013, primarily due to three factors: the growth in our loan portfolio was focused on loan types with lower loss ratios based on our historical loss experience, the historical loan loss factors improved as the losses incurred in earlier periods aged and, therefore were weighted less in the calculation, and the portion of the allowance for loan losses attributable to loans individually evaluated for impairment decreased \$1.3 million, or 77.9%, to \$375,000 at December 31, 2013, compared to \$1.7 million at December 31, 2012.

Although our loan portfolio increased by \$63.5 million for the year ended December 31, 2013; the combined impact of these three factors was sufficient to fully fund the allowance to reflect the increase in the loan portfolio.

Net charge-offs were \$3.2 million and \$45.2 million, respectively, for the years ended December 31, 2013 and 2012, and \$13.2 million for the year ended December 31, 2011. The \$31.5 million provision for loan losses for 2012 included a \$11.5 million charge relating to the consummation of two bulk loan sales and a \$5.9 million charge relating to the transfer of loans to the held for sale portfolio in preparation for a bulk sale.

A loan balance is classified as a loss and charged-off when it is confirmed that there is no readily apparent source of repayment for the amount of the loan that is classified as loss. Confirmation can occur upon the receipt of updated third-party appraisal

valuation information indicating that there is a low probability of repayment upon sale of the collateral, the final disposition of collateral where the net proceeds are insufficient to pay the loan balance in full, our failure to obtain possession of certain consumer-loan collateral within certain time limits specified by applicable federal regulations, the conclusion of legal proceedings where the borrower's obligation to repay is legally discharged (such as a federal Chapter 7 bankruptcy proceeding), or when it appears that further formal collection procedures are not likely to result in net proceeds in excess of the costs to collect.

### Allocation of Allowance for Loan Losses

The following table sets forth our allowance for loan losses allocated by loan category. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

At December 31,										
2013			2012			2011				
Allowance for Loan Losses	Loan Balances by Category	Percent of Loans in Each Category to Total Loans	Allowance for Loan Losses	Loan Balances by Category	Percent of Loans in Each Category to Total Loans	Allowance for Loan Losses	Loan Balances by Category	Percent of Loans in Each Category to Total Loans		
(Dollars in thousands)										
One-to-four family residential	\$ 3,848	\$ 201,382	18.12%	\$ 4,726	\$ 218,596	20.86%	\$ 6,103	\$ 272,032	21.62%	
Multi-family mortgage	4,444	396,058	35.64	4,580	352,019	33.60	6,082	423,615	33.67	
Nonresidential real estate	3,735	263,567	23.72	5,545	264,672	25.26	13,756	311,641	24.77	
Construction and land	393	6,570	0.59	1,031	8,552	0.82	1,684	19,852	1.58	
Commercial loans	731	54,255	4.88	1,324	61,388	5.86	3,539	93,932	7.46	
Commercial leases	946	187,112	16.84	666	139,783	13.34	504	134,990	10.73	
Consumer	57	2,317	0.21	163	2,745	0.26	58	2,147	0.17	
	<u>\$ 14,154</u>	<u>\$ 1,111,261</u>	<u>100.00%</u>	<u>\$ 18,035</u>	<u>\$ 1,047,755</u>	<u>100.00%</u>	<u>\$ 31,726</u>	<u>\$ 1,258,209</u>	<u>100.00%</u>	

At December 31,											
2010			2009								
Allowance for Loan Losses	Loan Balances by Category	Percent of Loans in Each Category to Total Loans	Allowance for Loan Losses	Loan Balances by Category	Percent of Loans in Each Category to Total Loans						
(Dollars in thousands)											
One-to-four family residential	\$ 3,556	\$ 256,300	23.92%	\$ 3,333	\$ 289,623	23.44%					
Multi-family mortgage	7,032	296,916	27.71	3,597	329,227	26.65					
Nonresidential real estate	5,714	281,987	26.31	5,696	316,607	25.62					
Construction and land	2,461	18,398	1.72	1,861	32,577	2.64					
Commercial loans	2,879	64,679	6.04	2,520	88,067	7.13					
Commercial leases	518	151,107	14.10	1,591	176,821	14.31					
Consumer	20	2,182	0.20	24	2,539	0.21					
	<u>\$ 22,180</u>	<u>\$ 1,071,569</u>	<u>100.00%</u>	<u>\$ 18,622</u>	<u>\$ 1,235,461</u>	<u>100.00%</u>					

## Sources of Funds

**Deposits.** At December 31, 2013, our deposits totaled \$1.253 billion. Interest-bearing deposits totaled \$1.126 billion and noninterest-bearing demand deposits totaled \$126.7 million. NOW, savings and money market accounts totaled \$850.4 million. Noninterest-bearing demand deposits at December 31, 2013 included \$3.1 million in internal checking accounts, such as accounts for Bank cashier's checks and money orders. At December 31, 2013, we had \$275.6 million of certificates of deposit outstanding, of which \$203.4 million had maturities of one year or less. Although we have a significant portion of our deposits in shorter-term certificates of deposit, we believe, based on historical experience and our current pricing strategy, that we will retain a significant portion of these accounts upon maturity.

The following table sets forth the distribution of total deposit accounts, by account type.

	Years Ended December 31,									
	2013			2012			2011			
	Average Balance	Percent	Weighted Average Rate	Average Balance	Percent	Weighted Average Rate	Average Balance	Percent	Weighted Average Rate	
(Dollars in thousands)										
Noninterest-bearing demand:										
Retail	\$ 39,160	3.11%	—%	\$ 39,171	3.04%	—%	\$ 39,319	2.94%	—%	
Commercial	90,595	7.21	—	95,636	7.41	—	92,376	6.90	—	
Total noninterest-bearing demand	129,755	10.32	—	134,807	10.45	—	131,695	9.84	—	
Savings deposits	147,444	11.73	0.10	144,684	11.22	0.10	135,127	10.10	0.16	
Money market accounts	343,823	27.36	0.34	346,118	26.84	0.36	350,228	26.17	0.45	
Interest-bearing NOW accounts	347,528	27.65	0.11	335,552	26.02	0.12	323,295	24.15	0.15	
Certificates of deposit	288,351	22.94	0.67	328,529	25.47	0.77	398,059	29.74	1.10	
	<u>\$ 1,256,901</u>	<u>100.00%</u>		<u>\$ 1,289,690</u>	<u>100.00%</u>		<u>\$ 1,338,404</u>	<u>100.00%</u>		

The following table sets forth certificates of deposit by time remaining until maturity at December 31, 2013:

	Maturity				
	3 Months or Less	Over 3 to 6 Months	Over 6 to 12 Months	Over 12 Months	Total
(Dollars in thousands)					
Certificates of deposit less than \$100,000	\$ 41,892	\$ 38,285	\$ 57,153	\$ 47,768	\$ 185,098
Certificates of deposit of \$100,000 or more	22,038	17,284	26,767	24,435	90,524
Total certificates of deposit	<u>\$ 63,930</u>	<u>\$ 55,569</u>	<u>\$ 83,920</u>	<u>\$ 72,203</u>	<u>\$ 275,622</u>

**Borrowings.** Our borrowings consist primarily of Federal Home Loan Bank advances and repurchase agreements. The following table sets forth information concerning balances and interest rates on our borrowings.

	At or For the Years Ended December 31,		
	2013	2012	2011
(Dollars in thousands)			
Balance at end of year	\$ 3,055	\$ 5,567	\$ 9,322
Average balance during year	2,964	8,162	12,758
Maximum outstanding at any month end	3,398	10,081	15,550
Weighted average interest rate at end of year	0.25%	1.73%	1.13%
Average interest rate during year	0.47%	1.27%	1.74%

At December 31, 2013, we had the capacity to borrow an additional \$251.4 million under our credit facilities with the FHLBC. Furthermore, we had unpledged securities that could be used to support in excess of \$37.3 million of additional FHLBC borrowings.

At December 31, 2013, we had a line of credit with the Federal Reserve Bank of Chicago. At December 31, 2013, there were no outstanding federal funds borrowings and there was no outstanding balance on the line of credit.

### **Impact of Inflation and Changing Prices**

The Company's consolidated financial statements and the related notes have been prepared in accordance with GAAP. GAAP generally requires the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. The impact of inflation, if any, is reflected in the increased cost of our operations. Unlike industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market interest rates have a greater impact on performance than the effects of inflation.

### **Management of Interest Rate Risk**

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

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

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

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

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

Our dynamic GAP analysis determines the relative balance between the repricing of assets and liabilities over multiple periods of time (ranging from overnight to five years). Dynamic GAP analysis includes expected cash flows from loans and mortgage-backed

securities, applying prepayment rates based on the differential between the current interest rate and the market interest rate for each loan and security type. This analysis identifies mismatches in the timing of asset and liability repricing but does not necessarily provide an accurate indicator of interest rate risk because it omits the factors incorporated into the net interest income analysis.

**Quantitative Analysis.** The following table sets forth, as of December 31, 2013, the estimated changes in the Bank's NPV and net interest income that would result from the designated instantaneous parallel shift in the U.S. Treasury yield curve. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

Change in Interest Rates (basis points)	Estimated Decrease in NPV		Decrease in Estimated Net Interest Income	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
+400	\$ (32,784)	(20.23)%	\$ (8,491)	(19.21)%
+300	(17,119)	(10.56)	(6,148)	(13.91)
+200	(11,655)	(7.19)	(3,926)	(8.88)
+100	(5,389)	(3.32)	(2,006)	(4.54)
0	—	—	—	—

The Company has opted not to include an estimate for a decrease in rates at December 31, 2013 as the results are not relevant given the current targeted fed funds rate of the Federal Open Market Committee. The table set forth above indicates that at December 31, 2013, in the event of an immediate 200 basis point increase in interest rates, the Bank would be expected to experience a 7.19% decrease in NPV and a \$3.9 million decrease in net interest income. This data does not reflect any actions that we may undertake in response to changes in interest rates, such as changes in rates paid on certain deposit accounts based on local competitive factors, which could reduce the actual impact on NPV and net interest income, if any.

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

## Liquidity Management

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

Our primary sources of funds are deposits, principal and interest payments on loans and securities, and, to a lesser extent, wholesale borrowings, the proceeds from maturing securities and short-term investments, and the proceeds from the sales of loans and securities. The scheduled amortization of loans and securities, as well as proceeds from borrowings, are predictable sources of funds. Other funding sources, however, such as deposit inflows, mortgage prepayments and mortgage loan sales are greatly influenced by market interest rates, economic conditions and competition.

Our cash flows are derived from operating activities, investing activities and financing activities as reported in the Consolidated Statements of Cash Flows in our Consolidated Financial Statements. Our primary investing activities are the origination for investment of one-to-four family residential mortgage loans, multi-family mortgage loans, nonresidential real estate loans, commercial leases, construction and land loans, and commercial loans and the purchase of investment securities and mortgage-backed securities. During the years ended December 31, 2013, 2012 and 2011, our loans originated for investment totaled \$524.6 million, \$364.6 million, and \$573.2 million, respectively. Purchases of loans totaled \$5.6 million and \$154.2 million for the years

ended December 31, 2012 and 2011, respectively. There no loan purchases in the year ended December 31, 2013. Purchases of securities totaled \$74.2 million, \$35.4 million and \$37.6 million for the years ended December 31, 2013, 2012, and 2011, respectively.

These activities were funded primarily by principal repayments on loans and securities, and the sale of loans and securities. During the years ended December 31, 2013, 2012 and 2011, principal repayments on loans totaled \$453.2 million, \$518.3 million, and \$632.9 million, respectively. During the years ended December 31, 2013, 2012 and 2011, principal repayments on securities totaled \$13.5 million, \$19.7 million, and \$30.7 million, respectively. During the years ended December 31, 2013, 2012 and 2011, proceeds from maturities and sales of securities totaled \$26.8 million, \$30.6 million, and \$43.8 million, respectively. During the years ended December 31, 2013, 2012 and 2011, the proceeds from the sale of loans held for sale totaled \$11.7 million, \$21.0 million, \$17.6 million, respectively.

Loan origination commitments totaled \$29.3 million at December 31, 2013, and consisted of \$17.3 million of fixed-rate loans and \$12.0 million of adjustable-rate loans. Unused lines of credit and standby letters of credit granted to customers totaled \$118.2 million and \$922,000, respectively, at December 31, 2013. At December 31, 2013, commitments to sell mortgages totaled \$222,000.

Deposit flows are generally affected by the level of market interest rates, the interest rates and other terms and conditions on deposit products offered by our banking competitors, and other factors. We had net deposit decreases of \$29.6 million and \$50.0 million for the years ended December 31, 2013, and 2012, respectively, and a net deposit increase of \$97.2 million in 2011. At times during recent periods, we have not actively competed for higher cost deposit accounts, including certificates of deposit, choosing instead to fund loan growth from the loan and lease repayments. Certificates of deposit that are scheduled to mature in one year or less from December 31, 2013 totaled \$203.4 million. Based upon prior experience and our current pricing strategy, we believe that we will retain a significant portion of these deposits upon their maturities.

We anticipate that we will have sufficient funds available to meet current loan commitments and lines of credit and maturing certificates of deposit that are not renewed or extended. We generally remain fully invested and may utilize additional sources of funds through FHLBC advances, of which none were outstanding at December 31, 2013. At December 31, 2013 we had the ability to borrow an additional \$251.4 million under our credit facilities with the FHLBC. Furthermore, we have unpledged securities that could be used to support borrowings in excess of \$37.3 million. Finally, at December 31, 2013, we had a line of credit available with the Federal Reserve Bank of Chicago. At December 31, 2013, there was no outstanding balance on this credit line.

**Liquidity Management - Company.** The liquidity needs of the Company on an unconsolidated basis consist primarily of operating expenses, dividends to stockholders and stock repurchases. The primary sources of liquidity for the Company currently are \$11.4 million of cash and cash equivalents. and any cash dividends from the Bank.

The Dodd-Frank Act provided for the transfer of the authority for regulating and supervising federal savings banks from the OTS to the OCC, and the authority for regulating and supervising savings and loan holding companies and their non-depository subsidiaries from the OTS to the FRB. The transfer occurred on July 21, 2011.

As a result of the regulatory restructuring occasioned by the Dodd-Frank Act, the Company is subject to Federal Reserve Board Supervisory Letter SR 09-4, which provides that a holding company should, among other things, notify and make a submission to the Federal Reserve Bank prior to declaring a dividend if its net income for the current quarter is not sufficient to fully fund the dividend, and consider eliminating, deferring or significantly reducing its dividends if its net income for the current quarter is not sufficient to fully fund the dividends, or if its net income for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends. The Company will continue to consult with, and seek the prior approval of, the Federal Reserve Bank prior to declaring any dividends. Our Board of Directors declared four quarterly cash dividends of \$0.01 per share during 2013, totaling \$844,000.

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

As of December 31, 2013, we were not aware of any known trends, events or uncertainties that had or were reasonably likely to have a material impact on our liquidity. As of December 31, 2013, we had no other material commitments for capital expenditures.

## **Capital Management**

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

The Bank is subject to regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by the OCC that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by regulators about components, risk weightings, and other factors.

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

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

At December 31, 2013, actual capital ratios and minimum required ratios were:

	Consolidated Actual Ratio	BankFinancial F.S.B. Actual Ratio	Minimum required to be Well Capitalized Under Prompt Corrective Action Provisions	Minimum Capital Ratios Established under Capital Plans
Total capital (to risk-weighted assets)	17.28%	14.93%	8.00%	12.00%
Tier 1 (core) capital (to risk-weighted assets)	16.03	13.68	4.00	8.00
Tier 1 (core) capital (to adjusted total assets)	11.92	10.16	4.00	8.00

See Note 11 of the "Notes to Consolidated Financial Statements" in Item 8 of this Form 10-K for a reconciliation of the Bank's equity under GAAP to regulatory capital.

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

**Capital Management - Company.** On June 23, 2005, the Company completed its mutual-to-stock conversion and sold 24,466,250 shares of common stock in a subscription offering at \$10.00 per share and raised \$240.3 million in offering proceeds, net of offering expenses. The Company contributed \$120.9 million of the net proceeds to the Bank, paid off \$30 million of term borrowings, loaned \$19.6 million to our ESOP and retained the remaining net proceeds of \$72 million. Subsequent to the mutual-to-stock conversion, the Bank declared aggregate dividends of \$60.0 million to the Company. During this period the Company paid dividends totaling \$35.1 million and expended \$64.6 million for share repurchases.

Total stockholders' equity was \$175.6 million at December 31, 2013, compared to \$172.9 million at December 31, 2012. The increase in total stockholders' equity was primarily due to the combined impact of our \$3.3 million of net income and our declaration and payment of cash dividends totaling \$844,000 during the year ended December 31, 2013. The unallocated shares of common stock that our ESOP owns were reflected as a \$11.3 million reduction to stockholders' equity at December 31, 2013, compared to a \$12.2 million reduction to stockholders' equity at December 31, 2012.

**Quarterly Cash Dividends.** Our Board of Directors declared four quarterly cash dividends of \$0.01 per share during 2013, totaling \$844,000. As a result of the regulatory restructuring occasioned by the Dodd-Frank Act, the Company is subject to Federal Reserve Board Supervisory Letter SR 09-4, which provides that a holding company should, among other things, notify and make a submission



to the Federal Reserve Bank prior to declaring a dividend if its net income for the current quarter is not sufficient to fully fund the dividend, and consider eliminating, deferring or significantly reducing its dividends if its net income for the current quarter is not sufficient to fully fund the dividends, or if its net income for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends. The Company will continue to consult with, and seek the prior approval of, the Federal Reserve Bank prior to declaring any dividends.

**Stock Repurchase Program.** Our Board of Directors had authorized the repurchase of up to 5,047,423 shares of our common stock. The repurchase authorization expired on November 15, 2012. The authorization permitted shares to be repurchased in open market or negotiated transactions, and pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission. The authorization was utilized at management's discretion, subject to the limitations set forth in Rule 10b-18 of the Securities and Exchange Commission and other applicable legal requirements, and to price and other internal limitations established by the Board of Directors. As of December 31, 2013, the Company had repurchased 4,239,134 shares of its common stock out of the 5,047,423 shares that had been authorized for repurchase. Federal Reserve Board Supervisory Letter SR 09-4 provides that holding companies experiencing financial weaknesses such as operating losses should notify and make a submission to the Federal Reserve Bank before redeeming or repurchasing common stock. The Company has no plans to conduct such discussions with the Federal Reserve supervisory staff or engage in stock repurchases at this time.

#### Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

**Commitments.** As a financial services provider, we routinely are a party to various financial instruments with off-balance-sheet risks, such as commitments to extend credit, standby letters of credit, unused lines of credit and commitments to sell loans. While these contractual obligations represent our future cash requirements, a significant portion of commitments to extend credit may expire without being drawn upon. Such commitments are subject to the same credit policies and approval process afforded to loans that we make. Although we consider commitments to extend credit in determining our allowance for loan losses, at December 31, 2013, we had made no provision for losses on commitments to extend credit, and had no specific or general allowance for losses on such commitments, as we have had no historical loss experience with commitments to extend credit and we believed that no probable and reasonably estimable losses were inherent in our portfolio as a result of our commitments to extend credit. For additional information, see Note 14 of the "Notes to Consolidated Financial Statements" in Item 8 of this Form 10-K.

**Contractual Obligations.** In the ordinary course of our operations, we enter into certain contractual obligations. Such obligations include operating leases for premises and equipment.

The following table summarizes our significant fixed and determinable contractual obligations and other funding needs by payment date at December 31, 2013. The payment amounts represent those amounts due to the recipient and do not include any unamortized premiums or discounts or other similar carrying amount adjustments.

	Payments Due by Period					Total
	Less than One Year	One to Three Years	Three to Five Years	More than Five Years		
(Dollars in thousands)						
<b>Contractual Obligations</b>						
Certificates of deposit	\$ 203,419	\$ 64,298	\$ 7,905	\$ —	\$ —	\$ 275,622
Borrowings	—	—	—	—	—	—
Standby letters of credit	912	10	—	—	—	922
Operating leases	439	885	948	5,637	—	7,909
Total	\$ 204,770	\$ 65,193	\$ 8,853	\$ 5,637	\$ —	\$ 284,453
Commitments to extend credit	\$ 147,420	\$ —	\$ —	\$ —	\$ —	\$ 147,420

#### Critical Accounting Policies

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that the most critical accounting policy upon which our financial condition and results of operation depend, and which involves the most complex subjective decisions or assessments, is as follows:

**Allowance for Loan Losses.** Arriving at an appropriate level of allowance for loan losses involves a high degree of judgment. Our allowance for loan losses provides for probable incurred losses based upon evaluations of known and inherent risks in the loan portfolio. We review the level of the allowance on a quarterly basis and establish the provision for loan losses based upon historical loan loss experience, the nature and volume of the loan portfolio, information about specific borrower situations, estimated collateral values, economic conditions and other factors to assess the adequacy of the allowance for loan losses. Among the material estimates that we must make to establish the allowance are loss exposure at default; the amount and timing of future cash flows on affected loans; the value of collateral; and a determination of loss factors to be applied to the various elements of the loan portfolio. All of these estimates are susceptible to significant change. Although we believe that we use the best information available to us to establish the allowance for loan losses, future adjustments to the allowance may be necessary if borrower financial, collateral valuation or economic conditions differ substantially from the information and assumptions used in making the evaluation. In addition, as an integral part of their supervisory and/or examination process, our regulatory agencies periodically review the methodology and sufficiency of the allowance for loan losses. These agencies may require us to recognize additions to the allowance based on their inclusion, exclusion or modification of risk factors or differences in judgments of information available to them at the time of their examination. A large loss could deplete the allowance and require increased provisions to replenish the allowance, which would negatively affect earnings.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

For information regarding market risk see Item 7 - “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Management of Interest Rate Risk.”

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management of BankFinancial Corporation is responsible for establishing and maintaining effective internal control over financial reporting.

Management evaluates the effectiveness of internal control over financial reporting and tests for reliability of recorded financial information through a program of ongoing internal audits. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

The Company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. The Company’s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company’s assets that could have a material effect on the financial statements.

Management assessed the Company’s internal control over financial reporting as of December 31, 2013, as required by Section 404 of the Sarbanes-Oxley Act of 2002, based on the criteria for effective internal control over financial reporting described in the “1992 Internal Control-Integrated Framework,” adopted by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management concludes that, as of December 31, 2013, the Company’s internal control over financial reporting is effective.

The Company’s independent registered public accounting firm has issued their report on the effectiveness of the Company’s internal control over financial reporting. That report follows under the heading, Report of Independent Registered Public Accounting Firm.

/s/ F. Morgan Gasior

F. Morgan Gasior

Chairman of the Board, Chief Executive Officer and President

/s/ Paul A. Cloutier

Paul A. Cloutier

Executive Vice President and Chief Financial Officer

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have audited the accompanying consolidated statements of financial condition of BankFinancial Corporation (the “Company”) as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, changes in stockholders’ equity and cash flows for each of the years in the three-year period ended December 31, 2013. We also have audited the Company’s internal control over financial reporting as of December 31, 2013, based on criteria established in the *1992 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. The Company’s management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company’s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design, and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BankFinancial Corporation as of December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in the *1992 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*.

/s/ Crowe Horwath LLP

Oak Brook, Illinois  
March 14, 2014

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

	December 31,	
	2013	2012
<b>Assets</b>		
Cash and due from other financial institutions	\$ 15,781	\$ 20,361
Interest-bearing deposits in other financial institutions	145,176	255,403
Cash and cash equivalents	160,957	275,764
Securities, at fair value	110,907	77,832
Loans held-for-sale	—	2,166
Loans receivable, net of allowance for loan losses: December 31, 2013, \$14,154 and December 31, 2012, \$18,035	1,098,077	1,030,465
Other real estate owned, net	6,306	10,358
Stock in Federal Home Loan Bank, at cost	6,068	8,412
Premises and equipment, net	35,328	38,251
Accrued interest receivable	3,933	4,146
Core deposit intangible	2,433	3,038
Bank owned life insurance	21,958	21,645
FDIC prepaid expense	—	2,658
Other assets	7,627	6,457
<b>Total assets</b>	<b>\$ 1,453,594</b>	<b>\$ 1,481,192</b>
<b>Liabilities</b>		
<b>Deposits</b>		
Noninterest-bearing	\$ 126,680	\$ 134,597
Interest-bearing	1,126,028	1,147,754
<b>Total deposits</b>	<b>1,252,708</b>	<b>1,282,351</b>
<b>Borrowings</b>	<b>3,055</b>	<b>5,567</b>
Advance payments by borrowers taxes and insurance	10,432	10,705
Accrued interest payable and other liabilities	11,772	9,679
<b>Total liabilities</b>	<b>1,277,967</b>	<b>1,308,302</b>
<b>Commitments and contingent liabilities</b>		
<b>Stockholders' equity</b>		
Preferred Stock, \$0.01 par value, 25,000,000 shares authorized, none issued or outstanding	—	—
Common Stock, \$0.01 par value, 100,000,000 shares authorized; 21,101,966 shares issued at December 31, 2013 and 21,072,966 shares issued at December 31, 2012	211	211
Additional paid-in capital	193,594	193,590
Retained earnings (deficit)	(7,342)	(9,796)
Unearned Employee Stock Ownership Plan shares	(11,255)	(12,233)
Accumulated other comprehensive income	419	1,118
<b>Total stockholders' equity</b>	<b>175,627</b>	<b>172,890</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,453,594</b>	<b>\$ 1,481,192</b>

See accompanying notes to the consolidated financial statements

**BANKFINANCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In thousands, except share and per share data)

	For the years ended December 31,		
	2013	2012	2011
<b>Interest and dividend income</b>			
Loans, including fees	\$ 47,691	\$ 58,716	\$ 66,706
Securities	981	1,485	2,665
Other	720	526	337
Total interest income	49,392	60,727	69,708
<b>Interest expense</b>			
Deposits	3,639	4,343	6,693
Borrowings	14	104	222
Total interest expense	3,653	4,447	6,915
<b>Net interest income</b>	45,739	56,280	62,793
Provision for (recovery of) loan losses	(687)	31,522	22,723
<b>Net interest income after provision for (recovery of) loan losses</b>	46,426	24,758	40,070
<b>Noninterest income</b>			
Deposit service charges and fees	2,005	2,176	2,667
Other fee income	2,250	2,393	2,425
Insurance commissions and annuities income	474	510	659
Gain on sale of loans, net	1,469	841	340
Loss on disposition of premises and equipment, net	(43)	(156)	(19)
Loan servicing fees	461	486	538
Amortization and impairment of servicing assets	(168)	(320)	(267)
Earnings on bank owned life insurance	313	438	626
Trust	711	733	676
Other	662	622	499
Total noninterest income	8,134	7,723	8,144
<b>Noninterest expense</b>			
Compensation and benefits	26,195	25,791	26,106
Office occupancy and equipment	7,547	8,060	8,541
Advertising and public relations	925	733	895
Information technology	3,091	3,062	2,775
Supplies, telephone, and postage	1,697	1,840	1,829
Amortization of intangibles	605	633	1,689
Nonperforming asset management	2,638	5,211	4,431
Operations of other real estate owned	1,613	7,491	6,335
FDIC insurance premiums	1,913	1,779	1,441
Acquisition costs	—	—	1,761
Goodwill impairment	—	—	23,862
Other	5,038	4,990	4,870
Total noninterest expense	51,262	59,590	84,535
<b>Income (loss) before income taxes</b>	3,298	(27,109)	(36,321)
Income tax expense	—	—	12,375
<b>Net income (loss)</b>	\$ 3,298	\$ (27,109)	\$ (48,696)
Basic earnings (loss) per common share	\$ 0.16	\$ (1.36)	\$ (2.46)
Diluted earnings (loss) per common share	\$ 0.16	\$ (1.36)	\$ (2.46)
Weighted average common shares outstanding	20,020,838	19,888,517	19,770,023
Diluted weighted average common shares outstanding	20,025,321	19,888,517	19,770,023

See accompanying notes to the consolidated financial statements

**BANKFINANCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In thousands)

	For the years ended December 31,		
	2013	2012	2011
<b>Net income (loss)</b>	\$ 3,298	\$ (27,109)	\$ (48,696)
Unrealized holding gain (loss) on securities arising during the period	(699)	7	(1,113)
Tax effect	—	—	424
Other comprehensive income (loss) on securities, net of tax effect	(699)	7	(689)
<b>Comprehensive income (loss)</b>	<u>\$ 2,599</u>	<u>\$ (27,102)</u>	<u>\$ (49,385)</u>

See accompanying notes to the consolidated financial statements

**BANKFINANCIAL CORPORATION**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
(In thousands, except per share data)

	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Unearned Employee Stock Ownership Plan Shares	Accumulated Other Comprehen-sive Income (Loss)	Total
<b>Balance at January 1, 2011</b>	\$ 211	\$ 194,186	\$ 71,278	\$ (14,190)	\$ 1,800	\$ 253,285
Net loss	—	—	(48,696)	—	—	(48,696)
Other comprehensive loss, net of tax effect	—	—	—	—	(689)	(689)
Nonvested stock awards-stock-based compensation expense	—	53	—	—	—	53
Cash dividends declared on common stock (\$0.22 per share)	—	—	(4,636)	—	—	(4,636)
ESOP shares earned	—	(438)	—	978	—	540
<b>Balance at December 31, 2011</b>	211	\$ 193,801	17,946	(13,212)	1,111	199,857
Net loss	—	—	(27,109)	—	—	(27,109)
Other comprehensive income, net of tax effect	—	—	—	—	7	7
Nonvested stock awards-stock-based compensation expense	—	41	—	—	—	41
Cash dividends declared on common stock (\$0.03 per share)	—	—	(633)	—	—	(633)
ESOP shares earned	—	(252)	—	979	—	727
<b>Balance at December 31, 2012</b>	211	193,590	(9,796)	(12,233)	1,118	172,890
Net income	—	—	3,298	—	—	3,298
Other comprehensive loss, net of tax effect	—	—	—	—	(699)	(699)
Nonvested stock awards-stock-based compensation expense	—	86	—	—	—	86
Cash dividends declared on common stock (\$0.04 per share)	—	—	(844)	—	—	(844)
ESOP shares earned	—	(82)	—	978	—	896
<b>Balance at December 31, 2013</b>	<u>\$ 211</u>	<u>\$ 193,594</u>	<u>\$ (7,342)</u>	<u>\$ (11,255)</u>	<u>\$ 419</u>	<u>\$ 175,627</u>

See accompanying notes to the consolidated financial statements

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

	For the years ended December 31,		
	2013	2012	2011
<b>Cash flows from operating activities</b>			
Net income (loss)	\$ 3,298	\$ (27,109)	\$ (48,696)
Adjustments to reconcile to net income (loss) to net cash from operating activities			
Provision for (recovery of) loan losses	(687)	31,522	22,723
Goodwill impairment	—	—	23,862
ESOP shares earned	896	727	540
Stock-based compensation expense	86	41	53
Depreciation and amortization	4,453	4,546	4,559
Amortization of premiums and discounts on securities and loans	(736)	(2,502)	(1,290)
Amortization of core deposit and other intangible assets	605	633	1,689
Amortization and impairment of servicing assets	168	320	267
Net change in net deferred loan origination costs	(225)	163	469
Net loss on sale of other real estate owned	148	253	15
Net gain on sale of loans	(1,469)	(841)	(340)
Net loss on disposition of premises and equipment	43	156	19
Loans originated for sale	(10,771)	(18,639)	(16,466)
Proceeds from sale of loans	11,670	20,984	17,604
Other real estate owned valuation adjustments	550	5,559	3,970
Net change in:			
Deferred income tax	—	—	12,419
Accrued interest receivable	213	1,427	172
Earnings on bank owned life insurance	(313)	(438)	(626)
Other assets	(243)	1,400	(70)
Accrued interest payable and other liabilities	2,093	(1,189)	(894)
Net cash from operating activities	9,779	17,013	19,979
<b>Cash flows from investing activities</b>			
Securities			
Proceeds from maturities	26,813	30,590	34,101
Proceeds from principal repayments	13,492	19,668	30,692
Proceeds from sales of securities	—	—	9,677
Purchases of securities	(74,220)	(35,360)	(37,557)
Loans receivable			
Principal payments on loans receivable	453,153	518,330	632,918
Purchases of loans	—	(5,641)	(154,174)
Originated for investment	(524,592)	(364,596)	(573,185)
Proceeds from sale of loans	2,868	10,988	—
Proceeds of redemption of Federal Reserve Bank stock	—	—	155
Proceeds of redemption of Federal Home Loan Bank of Chicago stock	2,344	7,934	—
Proceeds from sale of other real estate owned	8,838	13,154	9,074
Purchase of premises and equipment, net	(10)	(2,335)	(2,370)
Cash acquired in acquisition	—	—	61,619
Net cash from (used in) investing activities	(91,314)	192,732	10,950

(Continued)



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

	For the years ended December 31,		
	2013	2012	2011
<b>Cash flows from financing activities</b>			
Net change in deposits	\$ (29,643)	\$ (50,026)	\$ (115,589)
Net change in borrowings	(2,512)	(3,755)	(14,427)
Net change in advance payments by borrowers for taxes and insurance	(273)	(271)	3,617
Cash dividends paid on common stock	(844)	(633)	(4,636)
Net cash used in financing activities	(33,272)	(54,685)	(131,035)
Net change in cash and cash equivalents	(114,807)	155,060	(100,106)
Beginning cash and cash equivalents	275,764	120,704	220,810
<b>Ending cash and cash equivalents</b>	<b>\$ 160,957</b>	<b>\$ 275,764</b>	<b>\$ 120,704</b>
<b>Supplemental disclosures of cash flow information:</b>			
Interest paid	\$ 3,697	\$ 4,502	\$ 6,849
Income taxes paid	—	—	3
Income taxes refunded	461	1,423	761
Loans transferred to other real estate owned	5,512	7,035	14,132
Loans transferred to held for sale	—	12,740	—
<b>Supplemental disclosures of noncash investing activities – Acquisition:</b>			
Noncash assets acquired:			
Securities	\$ —	\$ —	\$ 10,177
Loans receivable	—	—	118,147
Other real estate owned	—	—	6,965
Stock in Federal Home Loan Bank and Federal Reserve Bank	—	—	903
Goodwill	—	—	1,296
Premises and equipment, net	—	—	7,442
Accrued interest receivable	—	—	355
Core deposit intangible	—	—	2,660
FDIC prepaid expense	—	—	774
Income tax receivable	—	—	774
Deferred taxes, net	—	—	2,662
Other assets	—	—	42
Total noncash items acquired	—	—	152,197
Liabilities assumed:			
Deposits	—	—	212,939
Advance payments by borrowers taxes and insurance	—	—	34
Accrued interest payable and other liabilities	—	—	843
Total liabilities assumed	—	—	213,816
Cash and cash equivalents acquired	\$ —	\$ —	\$ 61,619

See accompanying notes to the consolidated financial statements

**BANKFINANCIAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

**Principles of Consolidation:** The consolidated financial statements include the accounts of and transactions of BankFinancial Corporation, the Bank, and the Bank’s wholly-owned subsidiaries, Financial Assurance Services, Inc. and BF Asset Recovery Corporation (collectively, “the Company”). All significant intercompany accounts and transactions have been eliminated.

**Nature of Business:** The Company’s revenues, operating income, and assets are primarily from the banking industry. Loan origination customers are mainly located in the greater Chicago metropolitan area. To supplement loan originations, the Company purchases mortgage loans. The loan portfolio is concentrated in loans that are primarily secured by real estate.

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

**Interest-bearing Deposits in Other Financial Institutions:** Interest-bearing deposits in other financial institutions maturing in less than 90 days are carried at cost.

**Cash Flows:** Cash and cash equivalents include cash, deposits with other financial institutions maturing in less than 90 days, and daily federal funds sold. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in other financial institutions, borrowings, and advance payments by borrowers for taxes and insurance.

**Securities:** Debt securities are classified as available-for-sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available-for-sale. Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income (loss), net of tax. Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are based on the amortized cost of the security sold. Declines in the fair value of securities below their cost that are other-than-temporary are reflected as realized losses. In determining if losses are other-than-temporary, management considers: (1) the length of time and extent that fair value has been less than cost or adjusted cost, as applicable, (2) the financial condition and near term prospects of the issuer, and (3) whether the Company has the intent to sell the debt security or it is more likely than not that the Company will be required to sell the debt security before the anticipated recovery.

Securities also include investments in certificates of deposit with maturities of greater than 90 days. These certificates of deposit are placed with insured institutions for varying maturities and amounts that are fully insured by the Federal Deposit Insurance Corporation (“FDIC”).

**Federal Home Loan Bank Stock:** The Bank is a member of the Federal Home Loan Bank system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. Federal Home Loan Bank of Chicago (“FHLBC”) stock is carried at cost and classified as a restricted security. Accounting guidance for FHLBC stock provides that, for impairment testing purposes, the value of long term investments such as our FHLBC common stock is based on the “ultimate recoverability” of the par value of the security without regard to temporary declines in value. Both cash and stock dividends are reported as income.

**Loans Held-for-Sale:** Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or estimated fair market value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Mortgage loans held-for-sale are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the fair value of the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Held for investment loans that have been transferred to held-for-sale are carried at the lower of cost or fair value. For held-for-sale loans, any decreases in value after transfer below cost are recognized in mortgage banking revenue in the Consolidated Statements of Operations and increases in fair value above cost are not recognized until the loans are sold. The credit component of any write down upon transfer to held-for-sale is reflected in charge-offs to the allowance for loan losses.

**BANKFINANCIAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

Fair market value is determined based on quoted market rates and our judgment of relevant market conditions. Gains and losses on the disposition of loans held-for-sale are determined on the specific identification method. Transferred mortgage loans sold in the secondary market are sold without retaining servicing rights.

**Loans and Loan Income:** Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the 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 in income over the term of the loan based on the amount of principal outstanding.

Premiums and discounts associated with loans purchased are amortized over the contractual term 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 is 90 days past due or when we do not expect to receive full payment of interest or principal. Past due status is based on the contractual terms of the loan.

All interest accrued but not received for loans that have been placed on nonaccrual status 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 status. Once a loan is placed on non-accrual status, the borrower must generally demonstrate at least six months of payment performance before the loan is eligible to return to accrual status. Generally, the Company utilizes the “90 days delinquent, still accruing” category of loan classification when: (1) the loan is repaid in full shortly after the period end date; (2) the loan is well secured and there are no asserted or pending legal barriers to its collection; or (3) the borrower has remitted all scheduled payments and is otherwise in substantial compliance with the terms of the loan, but the processing of payments actually received or the renewal of a loan has not occurred for administrative reasons.

**Impaired Loans:** Impaired loans consist of nonaccrual loans and troubled debt restructurings (“TDRs”). A loan is considered impaired when, based on current information and events, management believes that it is probable that we will be unable to collect all amounts due (both principal and interest) according to the original contractual terms of the loan agreement. Once a loan is determined to be impaired, the amount of impairment is measured based on the loan's observable fair value, the fair value of the underlying collateral less selling costs if the loan is collateral-dependent, or the present value of expected future cash flows discounted at the loan's effective interest rate. If the measurement of the impaired loan is less than the recorded investment in the loan, the bank's allowance for the impaired collateral dependent loan under ASC 310-10-35 is based on fair value (less costs to sell), but the charge-off (the confirmed “loss”) is based on the higher appraised value. The remaining recorded investment in the loan after the charge-off will have a loan loss allowance for the amount by which the estimated fair value of the collateral (less costs to sell) is less than its appraised value.

Impaired loans with specific reserves are reviewed quarterly for any changes that would affect the specific reserve. Any impaired loan for which a determination has been made that the economic value is permanently reduced is charged-off against the allowance for loan losses to reflect its current economic value in the period in which the determination has been made.

At the time a collateral-dependent loan is initially determined to be impaired, we review the existing collateral appraisal. If the most recent appraisal is greater than a year old, a new appraisal is obtained on the underlying collateral. Appraisals are updated with a new independent appraisal at least annually and are formally reviewed by our internal appraisal department upon receipt of a new appraisal. All impaired loans and their related reserves are reviewed and updated each quarter. With an immaterial number of exceptions, all appraisals and internal reviews are current under this methodology at December 31, 2013.

**Purchased Impaired Loans:** Purchased impaired loans are recorded at their estimated fair values on the respective purchase dates and are accounted for prospectively based on expected cash flows. No allowance for credit losses is recorded on these loans at the acquisition date. In determining the acquisition date fair value of purchased impaired loans, and in subsequent accounting, the Company reviews these loans on an individual basis. Expected future cash flows in excess of the fair value of loans at the purchase date (“accretable yield”) are recorded as interest income over the life of the loans if the timing and amount of the future cash flows can be reasonably estimated. The non-accretable yield represents estimated losses in the portfolio and is equal to the difference between contractually required payments and the cash flows expected to be collected at acquisition.

Subsequent to the purchase date, increases in cash flows over those expected at the purchase date are recognized as interest income prospectively. The present value of any decreases in expected cash flows after the purchase date is recognized by recording a charge-off through the allowance for loan losses.

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

**Troubled Debt Restructurings:** A loan is classified as a troubled debt restructuring when a borrower is experiencing financial difficulties that leads to a restructuring of the loan, and the Company grants concessions to the borrower in the restructuring that it would not otherwise consider. These concessions may include rate reductions, principal forgiveness, extension of maturity date and other actions intended to minimize potential losses.

In determining whether a debtor is experiencing financial difficulties, the Company considers if the debtor is in payment default or would be in payment default in the foreseeable future without the modification, the debtor declared or is in the process of declaring bankruptcy, there is substantial doubt that the debtor will continue as a going concern, the debtor has securities that have been or are in the process of being delisted, the debtor's entity-specific projected cash flows will not be sufficient to service any of its debt, or the debtor cannot obtain funds from sources other than the existing creditors at a market rate for debt with similar risk characteristics.

In determining whether the Company has granted a concession, the Company assesses, if it does not expect to collect all amounts due, whether the current value of the collateral will satisfy the amounts owed, whether additional collateral or guarantees from the debtor will serve as adequate compensation for other terms of the restructuring, and whether the debtor otherwise has access to funds at a market rate for debt with similar risk characteristics.

A loan that is modified at a market rate of interest will not be classified as troubled debt restructuring in the calendar year subsequent to the restructuring if it is in compliance with the modified terms. Payment performance prior and subsequent to the restructuring is taken into account in assessing whether it is likely that the borrower can meet the new terms. This may result in the loan being returned to accrual at the time of restructuring. A period of sustained repayment for at least six months generally is required for return to accrual status.

Periodically, the Company will restructure a note into two separate notes (A/B structure), charging off the entire B portion of the note. The A note is structured with appropriate loan-to-value and cash flow coverage ratios that provide for a high likelihood of repayment. The A note is classified as a nonperforming note until the borrower has displayed a historical payment performance for a reasonable time prior to and subsequent to the restructuring. A period of sustained repayment for at least six months generally is required to return the note to accrual status provided that management has determined that the performance is reasonably expected to continue. The A note will be classified as a restructured note (either performing or nonperforming) through the calendar year of the restructuring that the historical payment performance has been established.

**Allowance for Loan Losses:** The Company establishes provisions for loan losses, which are charged to the Company's results of operations to maintain the allowance for loan losses to absorb probable incurred credit losses in the loan portfolio. In determining the level of the allowance for loan losses, the Company considers past and current loss experience, trends in classified loans, evaluations of real estate collateral, current economic conditions, volume and type of lending, adverse situations that may affect a borrower's ability to repay a loan and the levels of nonperforming and other classified loans. The amount of the allowance is based on estimates and the ultimate losses may vary from the estimates as more information becomes available or events change.

The Company provides for loan losses based on the allowance method. Accordingly, all loan losses are charged to the related allowance and all recoveries are credited to it. Additions to the allowance for loan losses are provided by charges to income based on various factors that, in our judgment, deserve current recognition in estimating probable incurred credit losses. The Company reviews the loan portfolio on an ongoing basis and makes provisions for loan losses on a quarterly basis to maintain the allowance for loan losses in accordance with GAAP. The allowance for loan losses consists of two components:

- specific allowances established for any impaired residential non-owner occupied mortgage, multi-family mortgage, nonresidential real estate, construction and land, commercial, and commercial lease loans for which the recorded investment in the loan exceeds the measured value of the loan; and
- general allowances for loan losses for each loan class based on historical loan loss experience; and adjustments to historical loss experience (general allowances), maintained to cover uncertainties that affect our estimate of probable incurred credit losses for each loan class. If the remaining unamortized discount related to a specific pool of purchased performing loans exceeds the estimated credit losses associated with these loans, no general valuation allowance is recorded against the loans.

The adjustments to historical loss experience are based on our evaluation of several factors, including levels of, and trends in, past due and classified loans; levels of, and trends in, charge-offs and recoveries; trends in volume and terms of loans, including any credit concentrations in the loan portfolio; experience and ability of lending management and other relevant staff; and national and local economic trends and conditions.

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

The Company evaluates the allowance for loan losses based upon the combined total of the specific and general components. Generally, when the loan portfolio increases, absent other factors, the allowance for loan loss methodology results in a higher dollar amount of estimated probable incurred credit losses than would be the case without the increase. Conversely, when the loan portfolio decreases, absent other factors, the allowance for loan loss methodology generally results in a lower dollar amount of estimated probable losses than would be the case without the decrease.

The loss ratio used in computing the required general loan loss reserve allowance for a given class of loan consists of (i) the actual loss ratio (measured on a weighted, rolling twelve-quarter basis), (ii) the change in credit quality within the specific loan class during the period, (iii) the actual inherent risk factor assigned to the specific loan class and (iv) the actual concentration of risk factor assigned to the specific loan class (collectively, “the Specific Loan Class Risk Factors”). The Specific Loan Class Risk Factors are weighted equally in the calculation. In addition, two additional quantitative factors, the National Economic risk factor and the Local Economic risk factor, are also components of the computation but are given different weightings in their computation due to their relative applicability to the specific loan class in the context of the effect of national and local economic conditions on their risk profile and performance.

**Mortgage Servicing Rights:** Mortgage servicing rights are recognized separately when they are acquired through sales of loans. When mortgage loans are sold, servicing rights are initially recorded at fair value and gains on sales of loans are recorded in the statement of operations. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the servicing cost per loan, the discount rate, the escrow float rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. The Company compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Company later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. Changes in valuation allowances are reported with amortization and impairment of servicing assets on the statement of operations. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

Servicing fee income that is reported on the statement of operations as loan servicing fees is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. Late fees and ancillary fees related to loan servicing are not material.

**Other Real Estate Owned:** Real estate properties acquired in collection of a loan are initially recorded at fair value less cost to sell at acquisition, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Operating expenses, gains and losses on disposition, and changes in the valuation allowance are reported in noninterest expense as operations of other real estate owned (“OREO”).

**Premises and Equipment:** Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is included in noninterest expense and is computed on the straight-line method over the estimated useful lives of the assets. Useful lives are estimated to be 25 to 40 years for buildings and improvements that extend the life of the original building, ten to 20 years for routine building improvements, five to 15 years for furniture and equipment, two to five years for computer hardware and software and no greater than four years on automobiles. The cost of maintenance and repairs is charged to expense as incurred and significant repairs are capitalized.

**Goodwill and Other Intangible Assets:** Goodwill represents the excess of cost over the fair value of the net assets of businesses acquired. Goodwill and other intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually. The Company has selected December 31 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. The annual impairment analysis of goodwill includes identification of reporting units, the determination of the carrying value of each reporting unit, including the existing goodwill and intangible assets, and estimating

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

the fair value of each reporting unit. The Company identified one significant reporting unit—banking operations. The Company determined the fair value of our reporting unit and compared it to its carrying amount. If the carrying amount of a reporting unit exceeds its fair value, we are required to perform a second step to the impairment test.

Our annual impairment analysis as of December 31, 2011, indicated that the step two analysis was necessary. It was determined that the implied value of goodwill was less than the carrying amount, and the Company reduced the full carrying amount of goodwill with a charge to earnings.

Core deposit intangible assets (“CDI”), are recognized apart from goodwill at the time of acquisition based on valuations prepared by independent third parties or other estimates of fair value. In preparing such valuations, variables such as deposit servicing costs, attrition rates, and market discount rates are considered. CDI assets are amortized to expense over their useful lives.

**Bank Owned Life Insurance:** The Company has purchased life insurance policies on certain key executives. The Company owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

**Long-Term Assets:** Premises and equipment, core deposit and other intangible assets, and other long-term assets are reviewed for impairment when events indicate that their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

**Loan Commitments and Related Financial Instruments:** Financial instruments include off-balance-sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

**Income Taxes:** Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Under GAAP, a deferred tax asset valuation allowance is required to be recognized if it is “more likely than not” that the deferred tax asset will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management’s evaluation of both positive and negative evidence, the forecasts of future taxable income, applicable tax planning strategies, and assessments of current and future economic and business conditions. The Company considers both positive and negative evidence regarding the ultimate realizability of our deferred tax assets. Examples of positive evidence may include the existence, if any, of taxes paid in available carry-back years and the likelihood that taxable income will be generated in future periods. Examples of negative evidence may include a cumulative loss in the current year and prior two years and negative general business and economic trends. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period of the enactment date.

Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion, or all, of the deferred tax asset will not be realized. In assessing the realization of deferred tax assets, management evaluates both positive and negative evidence, including the existence of any cumulative losses in the current year and the prior two years, the amount of taxes paid in available carry-back years, the forecasts of future income, taking into account applicable tax planning strategies, and assessments of current and future economic and business conditions. This analysis is updated quarterly and adjusted as necessary. At December 31, 2013 and 2012, after considering both positive and negative evidence, the Company determined that a full valuation allowance for deferred tax assets was required.

**Retirement Plans:** Employee 401(k) and profit sharing plan expense is the amount of matching contributions and any annual discretionary contribution made at the discretion of the Company’s Board of Directors. Deferred compensation expense allocates the benefits over years of service.

**Employee Stock Ownership Plan (“ESOP”):** The cost of shares issued to the ESOP, but not yet allocated to participants, is shown as a reduction of stockholders’ equity. Compensation expense is based on the market price of shares as they are committed to be released to participant accounts. Dividends on allocated ESOP shares reduce retained earnings; dividends on unearned ESOP shares reduce debt and accrued interest.

**Earnings (Loss) Per Common Share:** Basic earnings (loss) per common share is net income (loss) divided by the weighted average number of common shares outstanding during the period. ESOP shares are considered outstanding for this calculation unless unearned. Diluted earnings (loss) per common share is net income (loss) divided by the weighted average number of common

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

shares outstanding during the period plus the dilutive effect of restricted stock shares and the additional potential shares issuable under stock options.

**Loss Contingencies:** Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe that there are such matters that will have a material effect on the financial statements as of December 31, 2013.

**Restrictions on Cash:** Cash on hand or on deposit with the Federal Reserve Bank which is required to meet regulatory reserve and clearing requirements, based on a percentage of deposits.

**Fair Values of Financial Instruments:** Fair values of financial instruments are estimated using relevant market value information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

**Comprehensive Income (Loss):** Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities, which are also recognized as separate components of stockholders' equity.

**Stock-based Compensation:** Compensation cost is recognized for stock options and restricted stock awards issued to employees, based on the fair value of these awards at the date of grant. The Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period.

**Transfers of Financial Assets:** Transfers of financial assets are accounted for as sales when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Operating Segments:** While management monitors the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Operating results are not reviewed by senior management to make resource allocation or performance decisions. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

**Reclassifications:** Certain reclassifications have been made in the prior year's financial statements to conform to the current year's presentation.

**Recent Accounting Pronouncements**

In July 2013, the FASB amended existing guidance related to the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. These amendments provide that an unrecognized tax benefit, or a portion thereof, be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except to the extent that a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date to settle any additional income taxes that would result from disallowance of a tax position, or the tax law does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, then the unrecognized tax benefit should be presented as a liability. Early adoption and retrospective application is permitted. The effect of adopting this standard did not have a material effect on the Company's operating results or financial condition.

In February 2013, the FASB amended existing guidance related to reporting amounts reclassified out of other comprehensive income out of accumulated other comprehensive income. These amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. These amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other

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**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

disclosures required under U.S. GAAP that provide additional details about those amounts. These amendments are effective prospectively for interim and annual reporting periods beginning after December 31, 2012. The effect of adopting this standard did not have a material effect on the Company's operating results or financial condition.

**NOTE 2 - EARNINGS (LOSS) PER SHARE**

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

	For the years ended December 31,		
	2013	2012	2011
<b>Net income (loss) available to common stockholders</b>	\$ 3,298	\$ (27,109)	\$ (48,696)
Average common shares outstanding	21,091,399	21,072,966	21,072,966
Less:			
Unearned ESOP shares	(1,054,140)	(1,182,495)	(1,294,478)
Unvested restricted stock shares	(16,421)	(1,954)	(8,465)
Weighted average common shares outstanding	20,020,838	19,888,517	19,770,023
Add - Net effect of dilutive stock options and unvested restricted stock	4,483	—	—
Weighted average dilutive common shares outstanding	20,025,321	19,888,517	19,770,023
<b>Basic earnings (loss) per common share</b>	\$ 0.16	\$ (1.36)	\$ (2.46)
<b>Diluted earnings (loss) per common share</b>	\$ 0.16	\$ (1.36)	\$ (2.46)
Number of antidilutive stock options excluded from the diluted earnings per share calculation	—	—	2,075,553
Weighted average exercise price of anti-dilutive option shares	\$ —	\$ —	\$ 16.54



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**NOTE 3 - SECURITIES**

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>December 31, 2013</b>				
Certificates of deposit	\$ 65,010	\$ —	\$ —	\$ 65,010
Municipal securities	180	7	—	187
Equity mutual fund	500	—	(3)	497
Mortgage-backed securities - residential	27,229	1,295	(160)	28,364
Collateralized mortgage obligations - residential	16,851	35	(72)	16,814
SBA-guaranteed loan participation certificates	35	—	—	35
	<u>\$ 109,805</u>	<u>\$ 1,337</u>	<u>\$ (235)</u>	<u>\$ 110,907</u>
<b>December 31, 2012</b>				
Certificates of deposit	\$ 33,456	\$ —	\$ —	\$ 33,456
Municipal securities	350	19	—	369
Equity mutual fund	500	28	—	528
Mortgage-backed securities - residential	32,572	1,661	—	34,233
Collateralized mortgage obligations - residential	9,111	95	(2)	9,204
SBA-guaranteed loan participation certificates	42	—	—	42
	<u>\$ 76,031</u>	<u>\$ 1,803</u>	<u>\$ (2)</u>	<u>\$ 77,832</u>

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

The amortized cost and fair values of securities at December 31, 2013 by contractual maturity are shown below. Securities not due at a single maturity date are shown separately. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2013	
	Amortized Cost	Fair Value
Due in one year or less	\$ 65,190	\$ 65,197
Equity mutual fund	500	497
Mortgage-backed securities - residential	27,229	28,364
Collateralized mortgage obligations - residential	16,851	16,814
SBA-guaranteed loan participation certificates	35	35
	<u>\$ 109,805</u>	<u>\$ 110,907</u>

Investment securities available for sale with carrying amounts of \$8.0 million and \$9.4 million at December 31, 2013 and 2012, respectively, were pledged as collateral on customer repurchase agreements and for other purposes as required or permitted by law.

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**NOTE 3 - SECURITIES** (continued)

Sales of securities were as follows:

	For the years ended December 31,		
	2013	2012	2011
Proceeds	\$ —	\$ —	\$ 9,677
Gross gains	—	—	—
Gross losses	—	—	—

Securities with unrealized losses at December 31, 2013 and 2012 not recognized in income are as follows:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
<b>December 31, 2013</b>						
Equity mutual fund	\$ 497	\$ (3)	\$ —	\$ —	\$ 497	\$ (3)
Mortgage-backed securities - residential	2,806	(160)	—	—	2,806	(160)
Collateralized mortgage obligations - residential	11,233	(72)	—	—	11,233	(72)
	\$ 14,536	\$ (235)	\$ —	\$ —	\$ 14,536	\$ (235)
<b>December 31, 2012</b>						
Collateralized mortgage obligations - residential	\$ —	\$ —	\$ 1,956	\$ (2)	\$ 1,956	\$ (2)

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

An equity mutual fund and certain residential mortgage-backed securities and collateralized mortgage obligations that the Company holds in its investment portfolio were in an unrealized loss position at December 31, 2013, but the unrealized loss was not considered significant under the Company's impairment testing methodology. In addition, the Company does not intend to sell these securities, and it is not likely that the Company will be required to sell the securities before their anticipated recovery occurs.

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**NOTE 4 – LOANS RECEIVABLE**

Loans receivable are as follows:

	December 31,	
	2013	2012
One-to-four family residential real estate	\$ 201,382	\$ 218,596
Multi-family mortgage	396,058	352,019
Nonresidential real estate	263,567	264,672
Construction and land	6,570	8,552
Commercial loans	54,255	61,388
Commercial leases	187,112	139,783
Consumer	2,317	2,745
	1,111,261	1,047,755
Net deferred loan origination costs	970	745
Allowance for loan losses	(14,154)	(18,035)
Loans, net	\$ 1,098,077	\$ 1,030,465

**Loan Origination/Risk Management.** The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. The Company reviews and approves these policies and procedures on a periodic basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and nonperforming and potential problem loans. The Company requires title insurance insuring the priority of our lien, fire and extended coverage casualty insurance, and, if appropriate, flood insurance, in order to protect our security interest in the underlying property.

The majority of the loans the Company originates are investment and business loans (multi-family, nonresidential real estate, commercial, construction and land loans, and commercial leases). In addition, we originate one-to-four family residential mortgage loans and consumer loans, and purchase and sell loan participations from time-to-time. The following briefly describes our principal loan products.

The Company originates real estate loans principally secured by first liens on nonresidential real estate. The nonresidential real estate properties are predominantly office buildings, light industrial buildings, shopping centers and mixed-use developments and, to a lesser extent, more specialized properties such as nursing homes and other healthcare facilities. The Company may, from time to time, purchase commercial real estate loan participations.

Multi-family mortgage loans generally are secured by multi-family rental properties such as apartment buildings, including subsidized apartment units. In general, loan amounts range between \$250,000 and \$3.0 million. Approximately 22% of the collateral is located outside of our primary market area; however, we do not have a concentration in any single market outside of our primary market territory. In underwriting multi-family mortgage loans, the Company considers a number of factors, which include the projected net cash flow to the loan's debt service requirement (generally requiring a minimum ratio of 115% for loans below \$400,000 and 120% for loans above \$400,000), the age and condition of the collateral, the financial resources and income level of the borrower and the borrower's experience in owning or managing similar properties. Multi-family mortgage loans are generally originated in amounts up to 80% of the appraised value of the property securing the loan. Personal guarantees are usually obtained from multi-family mortgage borrowers.

Loans secured by multi-family mortgages generally involve a greater degree of credit risk than one- to four-family residential mortgage loans and carry larger loan balances. This increased credit risk is a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family mortgages typically depends upon the successful operation of the related real estate property. If the cash flow from the project is reduced below acceptable thresholds, the borrower's ability to repay the loan may be impaired.

The Company emphasizes nonresidential real estate loans with initial principal balances between \$250,000 and \$3.0 million. Substantially all of our nonresidential real estate loans are secured by properties located in our primary market area. The Company's

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**NOTE 4 – LOANS RECEIVABLE** (continued)

nonresidential real estate loans are generally written as three- or five-year adjustable-rate mortgages or mortgages with balloon maturities of three or five years. Amortization on these loans is typically based on 20- to 25-year schedules. The Company also originates some 15-year fixed-rate, fully amortizing loans.

In the underwriting of nonresidential real estate loans, the Company generally lends up to 80% of the property's appraised value. Decisions to lend are based on the economic viability of the property as the primary source of repayment and the creditworthiness of the borrower. In evaluating a proposed commercial real estate loan, we emphasize the ratio of the property's projected net cash flow to the loan's debt service requirement (generally requiring a minimum ratio of 120%), computed after deduction for a vacancy factor and property expenses we deem appropriate. Personal guarantees are usually obtained from nonresidential real estate borrowers.

Nonresidential real estate loans generally carry higher interest rates and have shorter terms than those on one- to four-family residential mortgage loans. Nonresidential real estate loans, however, entail significant additional credit risks compared to one- to four-family residential mortgage loans, as they typically involve larger loan balances concentrated with single borrowers or groups of related borrowers. In addition, the payment of loans secured by income-producing properties typically depends on the successful operation of the related real estate project and thus may be subject to a greater extent to adverse conditions in the real estate market and in the general economy.

The Company makes various types of secured and unsecured commercial loans to customers in our market area for the purpose of financing equipment acquisition, expansion, working capital and other general business purposes. The terms of these loans generally range from less than one year to five years. The loans are either negotiated on a fixed-rate basis or carry adjustable interest rates indexed to (i) a lending rate that is determined internally, or (ii) a short-term market rate index.

Commercial credit decisions are based upon our credit assessment of the loan applicant. The Company determines the applicant's ability to repay in accordance with the proposed terms of the loans and we assess the risks involved. An evaluation is made of the applicant to determine character and capacity to manage. Personal guarantees of the principals are usually obtained. In addition to evaluating the loan applicant's financial statements, we consider the adequacy of the primary and secondary sources of repayment for the loan. Credit agency reports of the applicant's credit history supplement our analysis of the applicant's creditworthiness and at times are supplemented with inquiries to other banks and trade investigations. Collateral supporting a secured transaction also is analyzed to determine its marketability. Commercial business loans generally have higher interest rates than residential loans of like duration because they have a higher risk of default since their repayment generally depends on the successful operation of the borrower's business and the sufficiency of any collateral. Pricing of commercial loans is based primarily on the credit risk of the borrower, with due consideration given to borrowers with appropriate deposit relationships.

The Company also lends money to small and mid-size leasing companies for equipment financing leases. Generally, commercial leases are secured by an assignment by the leasing company of the lease payments and by a secured interest in the equipment being leased. The lessee acknowledges our security interest in the leased equipment and agrees to send lease payments directly to us. Consequently, the Company underwrites lease loans by examining the creditworthiness of the lessee rather than the lessor. Lease loans generally are non-recourse to the leasing company.

The Company's commercial leases are secured primarily by technology equipment, medical equipment, material handling equipment and other capital equipment. Lessees tend to be publicly-traded companies with investment-grade rated debt or companies that have not issued public debt and therefore do not have a public debt rating. The Company requires that a minimum of 50% of our commercial lessees have an investment grade public debt rating by Moody's or Standard & Poors, or the equivalent. Commercial leases to these entities have a maximum maturity of seven years and a maximum outstanding credit exposure of \$15.0 million to any single entity. Lessees without public debt ratings generally have net worth in excess of \$25.0 million. If the lessee does not have a public debt rating, they are subject to the same internal credit analysis as any other customer. Commercial leases to these lessees have a maximum maturity of five years and a maximum outstanding credit exposure of \$5.0 million to any single entity. In addition, the Company will originate commercial leases to lessees with below-investment grade public debt ratings, but these leases are limited to 10% of our commercial lease portfolio and have a maximum outstanding credit exposure of \$3.0 million to any single entity. Lease loans are almost always fully amortizing, with fixed interest rates.

Although the Company does not actively originate construction and land loans presently, construction and land loans generally consist of land acquisition loans to help finance the purchase of land intended for further development, including single-family homes, multi-family housing and commercial income property, development loans to builders in our market area to finance improvements to real estate, consisting mostly of single-family subdivisions, typically to finance the cost of utilities, roads, sewers

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

**NOTE 4 – LOANS RECEIVABLE** (continued)

and other development costs. These builders generally rely on the sale of single-family homes to repay development loans, although in some cases the improved building lots may be sold to another builder, often in conjunction with development loans. Construction and land loans typically involve a higher degree of credit risk than financing on improved, owner-occupied real estate. The risk of loss on construction and land loans is largely dependent upon the accuracy of the initial appraisal of the property's value upon completion of construction or development; the estimated cost of construction, including interest; and the estimated time to complete and/or sell or lease such property. The Company seeks to minimize these risks by maintaining consistent lending policies and underwriting standards. However, if the estimate of value proves to be inaccurate, the cost of completion is greater than expected, the length of time to complete and/or sell or lease the collateral property is greater than anticipated, or if there is a downturn in the local economy or real estate market, the property could have a value upon completion that is insufficient to assure full repayment of the loan. This could have a material adverse effect on the quality of the construction and land loan portfolio, and could result in significant losses or delinquencies.

The Company offers conforming and non-conforming, fixed-rate and adjustable-rate residential mortgage loans with maturities of up to 30 years and maximum loan amounts generally of up to \$2.5 million. The Company currently offers fixed-rate conventional mortgage loans with terms of 10 to 30 years that are fully amortizing with monthly payments, and adjustable-rate conventional mortgage loans with initial terms of between one and five years that amortize up to 30 years. One- to four-family residential mortgage loans are generally underwritten according to Fannie Mae guidelines, and loans that conform to such guidelines are referred to as "conforming loans." The Company generally originates both fixed- and adjustable-rate loans in amounts up to the maximum conforming loan limits as established by Fannie Mae, which is currently \$417,000 for single-family homes. Private mortgage insurance is required for first mortgage loans with loan-to-value ratios in excess of 80%.

The Company also originates loans above conforming limits, sometimes referred to as "jumbo loans," that have been underwritten to the credit standards of Fannie Mae. These loans are generally eligible for sale to various firms that specialize in the purchase of such non-conforming loans. In the Chicago metropolitan area, larger residential loans are not uncommon. The Company also originates loans at higher rates that do not fully meet the credit standards of Fannie Mae but are deemed to be acceptable risks.

The primary markets served by the Company have seen gradually broadening signs of stability amid widespread economic weakness and high unemployment. The ability of the Company's borrowers to repay their loans, and the value of the collateral securing such loans, could be adversely impacted by a return to economic weakness in its local markets as a result of unemployment, declining real estate values, or increased residential and office vacancies. This not only could result in the Company experiencing charge-offs and/or nonperforming assets, but also could necessitate an increase in the provision for loan losses. These events, if they were to recur, would have an adverse impact on the Company's results of operations and its capital.

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**NOTE 4 – LOANS RECEIVABLE (continued)**

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

	Allowance for loan losses				Loan Balances			
	Individually evaluated for impairment	Purchased impaired loans	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Purchased impaired loans	Collectively evaluated for impairment	Total
<b>December 31, 2013</b>								
One-to-four family residential real estate	\$ 26	\$ 5	\$ 3,817	\$ 3,848	\$ 3,692	\$ 100	\$ 197,590	\$ 201,382
Multi-family mortgage	255	—	4,189	4,444	7,031	—	389,027	396,058
Nonresidential real estate	77	—	3,658	3,735	4,381	1,633	257,553	263,567
Construction and land	12	—	381	393	383	—	6,187	6,570
Commercial loans	—	—	731	731	—	23	54,232	54,255
Commercial leases	—	—	946	946	—	—	187,112	187,112
Consumer	—	—	57	57	77	—	2,240	2,317
	<u>\$ 370</u>	<u>\$ 5</u>	<u>\$ 13,779</u>	<u>\$ 14,154</u>	<u>\$ 15,564</u>	<u>\$ 1,756</u>	<u>\$ 1,093,941</u>	<u>1,111,261</u>
Net deferred loan origination costs								970
Allowance for loan losses								(14,154)
Loans, net								<u>\$ 1,098,077</u>

	Allowance for loan losses				Loan Balances			
	Individually evaluated for impairment	Purchased impaired loans	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Purchase impaired loans	Collectively evaluated for impairment	Total
<b>December 31, 2012</b>								
One-to-four family residential real estate	\$ 137	\$ 5	\$ 4,584	\$ 4,726	\$ 5,256	\$ 380	\$ 212,960	\$ 218,596
Multi-family mortgage	729	—	3,851	4,580	4,801	—	347,218	352,019
Nonresidential real estate	401	8	5,136	5,545	11,918	2,568	250,186	264,672
Construction and land	294	96	641	1,031	2,210	1,021	5,321	8,552
Commercial loans	23	1	1,300	1,324	256	20	61,112	61,388
Commercial leases	—	—	666	666	—	—	139,783	139,783
Consumer	—	—	163	163	—	—	2,745	2,745
	<u>\$ 1,584</u>	<u>110</u>	<u>\$ 16,341</u>	<u>\$ 18,035</u>	<u>\$ 24,441</u>	<u>\$ 3,989</u>	<u>\$ 1,019,325</u>	<u>1,047,755</u>
Net deferred loan origination costs								745
Allowance for loan losses								(18,035)
Loans, net								<u>\$ 1,030,465</u>

**BANKFINANCIAL CORPORATION**  
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**NOTE 4 – LOANS RECEIVABLE** (continued)

Activity in the allowance for loan losses is as follows:

	For the years ended December 31,		
	2013	2012	2011
Beginning balance	\$ 18,035	\$ 31,726	\$ 22,180
Loans charged offs:			
One-to-four family residential real estate	(1,505)	(12,366)	(5,316)
Multi-family mortgage	(1,832)	(7,203)	(3,514)
Nonresidential real estate	(577)	(18,167)	(698)
Construction and land	(943)	(4,311)	(2,519)
Commercial loans	(425)	(4,960)	(1,394)
Commercial leases	—	(121)	(72)
Consumer	(55)	(103)	(93)
	(5,337)	(47,231)	(13,606)
Recoveries:			
One-to-four family residential real estate	447	233	51
Multi-family mortgage	236	539	125
Nonresidential real estate	519	328	73
Construction and land	463	250	—
Commercial loans	470	626	173
Consumer	8	42	7
	2,143	2,018	429
Net charge-off	(3,194)	(45,213)	(13,177)
Provision for (recovery of) loan losses	(687)	31,522	22,723
Ending balance	\$ 14,154	\$ 18,035	\$ 31,726

**Impaired loans**

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

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

**BANKFINANCIAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 4 – LOANS RECEIVABLE** (continued)

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

	Loan Balance	Recorded Investment	Partial Charge- off	Allowance for Loan Losses Allocated	Average Investment in Impaired Loans	Interest Income Recognized
<b>December 31, 2013</b>						
With no related allowance recorded						
One-to-four family residential real estate	\$ 3,656	\$ 2,540	\$ 1,102	\$ —	\$ 3,693	\$ 20
One-to-four family residential real estate - non-owner occupied	875	706	137	—	591	—
Multi-family mortgage	5,466	4,449	4	—	6,098	27
Wholesale commercial lending	—	—	—	—	306	—
Nonresidential real estate	4,062	3,313	253	—	4,054	33
Land	274	263	8	—	169	—
Commercial loans - secured	77	77	—	—	83	—
	<u>14,410</u>	<u>11,348</u>	<u>1,504</u>	<u>—</u>	<u>14,994</u>	<u>80</u>
With an allowance recorded						
One-to-four family residential real estate - non-owner occupied	490	438	38	26	393	2
Multi-family mortgage	3,144	2,541	573	255	2,998	125
Nonresidential real estate	1,343	1,048	255	77	2,148	15
Land	180	119	60	12	1,265	—
	<u>5,157</u>	<u>4,146</u>	<u>926</u>	<u>370</u>	<u>6,804</u>	<u>142</u>
	<u>\$ 19,567</u>	<u>\$ 15,494</u>	<u>\$ 2,430</u>	<u>\$ 370</u>	<u>\$ 21,798</u>	<u>\$ 222</u>



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**NOTE 4 – LOANS RECEIVABLE (continued)**

	Loan Balance	Recorded Investment	Partial Charge- off	Allowance for Loan Losses Allocated	Average Investment in Impaired Loans	Interest Income Recognized
<b>December 31, 2012</b>						
With no related allowance recorded						
One-to-four family residential real estate	\$ 5,250	\$ 4,216	\$ 1,027	\$ —	\$ 2,814	\$ 149
One-to-four family residential real estate - non-owner occupied	567	534	34	—	4,322	90
Multi-family mortgage	2,959	2,106	819	—	9,303	189
Nonresidential real estate	11,850	9,220	2,490	—	6,218	347
Commercial loans - unsecured	529	52	477	—	25	21
	<u>21,155</u>	<u>16,128</u>	<u>4,847</u>	<u>—</u>	<u>22,682</u>	<u>796</u>
With an allowance recorded						
One-to-four family residential real estate - non-owner occupied	626	499	128	137	1,996	13
Multi-family mortgage	3,182	2,645	521	729	6,562	20
Nonresidential real estate	2,825	2,549	266	401	21,077	20
Land	3,812	2,210	1,602	294	2,933	113
Commercial loans - secured	386	204	182	23	1,849	—
	<u>10,831</u>	<u>8,107</u>	<u>2,699</u>	<u>1,584</u>	<u>34,417</u>	<u>166</u>
	<u>\$ 31,986</u>	<u>\$ 24,235</u>	<u>\$ 7,546</u>	<u>\$ 1,584</u>	<u>\$ 57,099</u>	<u>\$ 962</u>

**Purchased Impaired Loans**

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

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
One-to-four family residential real estate	\$ 100	\$ 380
Nonresidential real estate	1,633	2,568
Land	—	1,021
Commercial loans	23	20
Outstanding balance	<u>\$ 1,756</u>	<u>\$ 3,989</u>
Carrying amount, net of allowance (\$5 at December 31, 2013, \$110 at December 31, 2012)	<u>\$ 1,751</u>	<u>\$ 3,879</u>

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 4 – LOANS RECEIVABLE** (continued)

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

	<b>For the years ended December 31,</b>	
	<b>2013</b>	<b>2012</b>
Beginning balance	\$ 196	\$ 2,270
Disposals	—	745
Reclassifications from nonaccretable difference	35	—
Accretion of income	194	1,329
Ending balance	<u>\$ 37</u>	<u>\$ 196</u>

For the above purchased impaired loans, the Company decreased the allowance for loan losses by \$105,000 for the year ended December 31, 2013 and increased the allowance for loan losses by \$110,000 for the year ended December 31, 2012.

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

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
Contractually required payments receivable of loans purchased		
One-to-four family residential real estate	\$ 832	\$ 1,143
Nonresidential real estate	1,999	3,884
Land	—	1,600
Commercial loans	222	597
	<u>\$ 3,053</u>	<u>\$ 7,224</u>

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

**BANKFINANCIAL CORPORATION**  
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**NOTE 4 – LOANS RECEIVABLE** (continued)**Nonaccrual loans**

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

	Loan Balance	Recorded Investment	Loans Past Due Over 90 Days, still accruing
<b>December 31, 2013</b>			
One-to-four family residential real estate	\$ 3,516	\$ 3,498	\$ —
One-to-four family residential real estate – non owner occupied	1,190	1,143	—
Multi-family mortgage	8,142	7,098	228
Nonresidential real estate	4,748	4,214	—
Land	387	382	—
Commercial loans – secured	77	77	—
Consumer	12	12	—
	<u>\$ 18,072</u>	<u>\$ 16,424</u>	<u>\$ 228</u>
<b>December 31, 2012</b>			
One-to-four family residential real estate	\$ 7,286	\$ 6,154	\$ 70
One-to-four family residential real estate – non owner occupied	1,420	1,145	—
Multi-family mortgage	5,246	3,517	242
Nonresidential real estate	12,249	8,985	—
Land	3,817	2,210	—
Commercial loans – secured	386	204	—
Commercial loans – unsecured	552	52	17
	<u>\$ 30,956</u>	<u>\$ 22,267</u>	<u>\$ 329</u>

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

The Company's reserve for uncollected loan interest was \$1.3 million and \$942,000 at December 31, 2013 and 2012, respectively. Except for purchased impaired loans, when a loan is on non-accrual status and the ultimate collectability of the total principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. Alternatively, when a loan is on non-accrual status but there is doubt concerning only the ultimate collectability of interest, contractual interest is credited to interest income only when received, under the cash basis method pursuant to the provisions of FASB ASC 310–10, as applicable. In all cases, the average balances are calculated based on the month-end balances of the financing receivables within the period reported pursuant to the provisions of FASB ASC 310–10, as applicable.

**BANKFINANCIAL CORPORATION**  
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**NOTE 4 – LOANS RECEIVABLE (continued)**
**Past Due Loans**

The following tables presents the aging of the recorded investment in past due loans at December 31, 2013 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
One-to-four family residential real estate	\$ 751	\$ 424	\$ 2,876	\$ 4,051	\$ 142,058	\$ 146,109
One-to-four family residential real estate - non-owner occupied	905	—	960	1,865	52,676	54,541
Multi-family mortgage	2,193	1,716	6,354	10,263	303,903	314,166
Wholesale commercial lending	—	—	—	—	78,531	78,531
Nonresidential real estate	4,432	1,363	3,969	9,764	249,194	258,958
Construction	—	—	—	—	2,486	2,486
Land	—	—	382	382	3,684	4,066
Commercial loans:						
Secured	9	—	—	9	15,971	15,980
Unsecured	25	—	—	25	4,117	4,142
Municipal loans	—	—	—	—	2,849	2,849
Warehouse lines	—	—	—	—	1,927	1,927
Health care	—	—	—	—	19,381	19,381
Aviation	—	—	—	—	1,102	1,102
Other	—	—	—	—	9,006	9,006
Commercial leases:						
Investment rated commercial leases	—	—	—	—	147,374	147,374
Below investment grade	8	—	—	8	14,739	14,747
Non-rated	—	—	—	—	23,175	23,175
Lease pools	—	—	—	—	3,011	3,011
Consumer	3	4	4	11	2,317	2,328
Total	<u>\$ 8,326</u>	<u>\$ 3,507</u>	<u>\$ 14,545</u>	<u>\$ 26,378</u>	<u>\$ 1,077,501</u>	<u>\$ 1,103,879</u>

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
<b>Purchased impaired loans</b>						
One-to-four family residential real estate - non-owner occupied	\$ —	\$ —	\$ 100	\$ 100	\$ —	\$ 100
Nonresidential real estate	—	—	1,631	1,631	—	1,631
Commercial loans – secured	—	—	23	23	—	23
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,754</u>	<u>\$ 1,754</u>	<u>\$ —</u>	<u>\$ 1,754</u>

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**NOTE 4 – LOANS RECEIVABLE (continued)**

The following tables presents the aging of the recorded investment in past due loans as December 31, 2012 by class of loans:

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

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
<b>Purchased impaired loans</b>						
One-to-four family residential real estate - non-owner occupied	\$ 327	\$ —	\$ 53	\$ 380	\$ —	\$ 380
Nonresidential real estate	—	—	1,125	1,125	1,443	2,568
Land	—	—	1,021	1,021	—	1,021
Commercial loans – secured	—	—	20	20	—	20
	<u>\$ 327</u>	<u>\$ —</u>	<u>\$ 2,219</u>	<u>\$ 2,546</u>	<u>\$ 1,443</u>	<u>\$ 3,989</u>

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**NOTE 4 – LOANS RECEIVABLE (continued)**
**Troubled Debt Restructurings**

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

The Company had \$3.3 million of TDRs at December 31, 2013, compared to \$11.2 million at December 31, 2012, with \$53,000 and \$318,000 in specific valuation reserves allocated at December 31, 2013 and 2012, respectively. The Company had no outstanding commitments to borrowers whose loans are classified as TDRs.

The following table presents loans classified as TDRs:

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
One-to-four family residential real estate	\$ 2,093	\$ 2,802
Multi-family mortgage	518	1,201
Nonresidential real estate	—	5,189
Accrual troubled debt restructured loans	2,611	9,192
One-to-four family residential real estate	342	767
Multi-family mortgage	384	938
Nonresidential real estate	—	270
Nonaccrual troubled debt restructured loans	726	1,975
	<u>\$ 3,337</u>	<u>\$ 11,167</u>

During the years ending December 31, 2013 and 2012, the terms of certain loans were modified and classified as TDRs. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

The following tables present TDRs that occurred during the year:

	<b>For the years ended December 31,</b>					
	<b>2013</b>			<b>2012</b>		
	<b>Number of loans</b>	<b>Pre-Modification outstanding recorded investment</b>	<b>Post-Modification outstanding recorded investment</b>	<b>Number of loans</b>	<b>Pre-Modification outstanding recorded investment</b>	<b>Post-Modification outstanding recorded investment</b>
One-to-four family residential real estate	7	\$ 1,249	\$ 1,249	24	\$ 2,091	\$ 2,091
One-to-four family residential real estate - non-owner occupied	1	71	46	—	—	—
Multi-family mortgage	—	—	—	1	700	503
Nonresidential real estate	—	—	—	7	7,147	5,062
	<u>8</u>	<u>\$ 1,320</u>	<u>\$ 1,295</u>	<u>32</u>	<u>\$ 9,938</u>	<u>\$ 7,656</u>

**BANKFINANCIAL CORPORATION**  
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**NOTE 4 – LOANS RECEIVABLE (continued)**

	Due to reduction in interest rate	Due to extension of maturity date	Due to permanent reduction in recorded investment	Total
<b>For the year ended December 31, 2013</b>				
One-to-four family residential real estate	\$ —	\$ 1,249	\$ 46	\$ 1,295
<b>For the year ended December 31, 2012</b>				
One-to-four family residential real estate	\$ 508	\$ 1,583	\$ —	\$ 2,091
Multi-family mortgage	—	—	503	503
Nonresidential real estate	—	—	5,062	5,062
	<u>\$ 508</u>	<u>\$ 1,583</u>	<u>\$ 5,565</u>	<u>\$ 7,656</u>

The TDRs described above had no impact on interest income, resulted in no change to the allowance for loan losses allocated and resulted in charge offs of \$25,000 for the year ended December 31, 2013. The TDRs decreased interest income by \$9,000, increased the allowance for loan losses allocated by \$62,000 and resulted in charge offs of \$2.0 million during the year ended December 31, 2012.

The following table presents TDRs for which there was a payment default within twelve months following the modification:

	For the years ended December 31,			
	2013		2012	
	Number of loans	Recorded investment	Number of loans	Recorded investment
One-to-four family residential real estate	—	\$ —	5	\$ 864
Nonresidential real estate	—	—	4	3,308
	<u>—</u>	<u>\$ —</u>	<u>9</u>	<u>\$ 4,172</u>

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

The TDRs that subsequently defaulted described above had no material impact on the allowance for loans losses during the year ending December 31, 2012.

The terms of certain other loans were modified during the year ending December 31, 2013 that did not meet the definition of a TDR. These loans have a total recorded investment of \$1.7 million and \$1.2 million at December 31, 2013 and 2012. The modification of these loans involved either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

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

**Credit Quality Indicators:**

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

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

**BANKFINANCIAL CORPORATION**  
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**NOTE 4 – LOANS RECEIVABLE** (continued)

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

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

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

As of December 31, 2013, and based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	Pass	Special Mention	Substandard	Nonaccrual	Total
One-to-four family residential real estate	\$ 140,716	\$ 269	\$ 1,941	\$ 3,508	\$ 146,434
One-to-four family residential real estate - non-owner occupied	53,010	—	693	1,245	54,948
Multi-family mortgage	299,058	6,471	3,890	7,031	316,450
Wholesale commercial lending	75,741	2,694	1,173	—	79,608
Nonresidential real estate	237,751	6,306	13,645	5,865	263,567
Construction	2,484	—	—	—	2,484
Land	2,871	—	832	383	4,086
Commercial loans:					
Secured	15,824	—	78	100	16,002
Unsecured	3,173	67	899	—	4,139
Municipal loans	2,812	—	—	—	2,812
Warehouse lines	1,904	—	—	—	1,904
Health care	19,330	—	—	—	19,330
Aviation	1,100	—	—	—	1,100
Other	8,968	—	—	—	8,968
Commercial leases:					
Investment rated commercial leases	146,471	—	—	—	146,471
Below investment grade	14,626	—	—	—	14,626
Non-rated	22,805	—	210	—	23,015
Lease pools	3,000	—	—	—	3,000
Consumer	2,316	—	1	—	2,317
	<u>\$ 1,053,960</u>	<u>\$ 15,807</u>	<u>\$ 23,362</u>	<u>\$ 18,132</u>	<u>\$ 1,111,261</u>



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**NOTE 4 – LOANS RECEIVABLE** (continued)

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

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

**NOTE 5 – SECONDARY MORTGAGE MARKET ACTIVITIES**

First mortgage loans serviced for others are not included in the accompanying consolidated statements of financial condition. The unpaid principal balances of these loans were \$164.6 million, \$186.8 million, and \$206.1 million at December 31, 2013, 2012, and 2011, respectively. Custodial escrow balances maintained in connection with the foregoing loan servicing activities were \$3.5 million, \$4.9 million, and \$5.8 million at December 31, 2013, 2012, and 2011, respectively.

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**NOTE 5 – SECONDARY MORTGAGE MARKET ACTIVITIES** (continued)

Capitalized mortgage servicing rights are included in other assets in the accompanying consolidated statements of financial condition. Activity for capitalized mortgage servicing rights and the related valuation allowance was as follows.

	December 31,	
	2013	2012
<b>Servicing rights</b>		
Beginning of year	\$ 1,090	\$ 1,219
Additions	74	136
Amortized to expense	(233)	(265)
End of year	<u>\$ 931</u>	<u>\$ 1,090</u>
<b>Valuation allowance</b>		
Beginning of year	\$ 70	\$ 15
Additions expensed	—	61
Reductions credited to expense	(65)	(6)
End of year	<u>\$ 5</u>	<u>\$ 70</u>
Carrying value of mortgage servicing rights	<u>\$ 926</u>	<u>\$ 1,020</u>
Fair value of mortgage servicing rights	<u>\$ 1,279</u>	<u>\$ 1,340</u>

The estimated fair value of mortgage servicing rights is the present value of the expected future cash flows over the projected life of the loan. Assumptions used in the present value calculation are based on actual performance of the underlying servicing along with general market consensus. The expected cash flow is the net amount of all mortgage servicing income and expense items. The expected cash flows are discounted at an interest rate appropriate for the associated risk given the current market conditions. Significant assumptions are as follows:

	December 31,	
	2013	2012
Prepayment speed	14.22%	15.86%
Discount rate	12.00%	12.00%
Average servicing cost per loan	\$65.00	\$72.00
Escrow float rate	1.67%	0.86%

Key economic assumptions used in measuring the fair value of the Company's mortgage servicing rights as of December 31, 2013 and the effect on the fair value of our mortgage servicing rights from adverse changes in those assumptions, are as follows:

Fair value of mortgage servicing rights	\$ 1,279
Weighted average annual prepayment speed	14.22%
Decrease in fair value from 10% adverse change	(27)
Decrease in fair value from 20% adverse change	(53)
Weighted-average annual discount rate	12.00%
Decrease in fair value from 10% adverse change	(47)
Decrease in fair value from 20% adverse change	(92)

These sensitivities are hypothetical and should be used with caution. As the above table indicates, changes in fair value based on variations in individual assumptions generally cannot be used to predict changes in fair value based upon further variations of the same assumptions. Also, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated in the above table independently, without changing any other assumption. In reality, changes in one factor may result in changes in another factor, which might magnify or counteract the sensitivities.

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**NOTE 5 – SECONDARY MORTGAGE MARKET ACTIVITIES** (continued)

The weighted average amortization period is 51 months. The estimated amortization expense for each of the next five years is as follows:

2014	\$	206
2015		139
2016		111
2017		89
2018		73

**NOTE 6 – PREMISES AND EQUIPMENT**

Year end premises and equipment are as follows:

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
Land and land improvements	\$ 13,600	\$ 13,605
Buildings and improvements	37,616	37,777
Furniture and equipment	9,950	10,173
Computer equipment	6,411	6,396
	<u>67,577</u>	<u>67,951</u>
Accumulated depreciation	(32,249)	(29,700)
	<u>\$ 35,328</u>	<u>\$ 38,251</u>

Depreciation of premises and equipment was \$2.9 million, \$3.1 million and \$3.1 million for the years ended December 31, 2013, 2012 and 2011, respectively.

The Company leases certain branch facilities under non-cancelable operating lease agreements expiring in various years through 2032. Rent expense, net of sublease income, for facilities was \$476,000, \$444,000, and \$601,000 in 2013, 2012, and 2011, respectively, excluding taxes, insurance, and maintenance. The projected minimum rental expense under existing leases, not including taxes, insurance, and maintenance, as of December 31, 2013 is as follows:

2014	\$	439
2015		440
2016		445
2017		469
2018		479
Thereafter		5,637
	<u>\$</u>	<u>7,909</u>

The Company has subleased some of its branch facilities and currently is entitled to receive income as follows:

2014	\$	39
2015		15
2016		14
2017		1
	<u>\$</u>	<u>69</u>

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**NOTE 7 – GOODWILL AND CORE DEPOSIT INTANGIBLE**

Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually. Due to high levels of volatility and dislocation in bank stock prices nationwide during 2011, as well as the Company's internal evaluation process, the Company engaged an independent valuation firm to determine the implied fair value of the Bank. The implied fair value of the Bank was estimated using weighted averages based on a price to tangible book value discount derived from the quoted market trading prices for similar institutions plus an estimated control premium and projected, discounted cash flows. Inputs from sales of comparable institutions were not assigned a weighting due to the small size of the group.

Our annual impairment analysis as of December 31, 2011, indicated that the step two analysis was necessary. Step two requires that the implied fair value of the reporting unit's goodwill be compared to the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss must be recognized in an amount equal to that excess. As a result of the step two evaluation, it was determined that the implied value of goodwill of the reporting unit was less than the carrying amount, and the Company reduced the full carrying amount of goodwill with a charge to earnings.

The changes in the carrying amount of goodwill and accumulated impairment charge are as follows:

	<b>As of and for the year ended December 31, 2011</b>
Balance at the beginning of the year	\$ 22,566
Additions	1,296
	<u>23,862</u>
Impairment charge	(23,862)
Net Carrying Value	<u>\$ —</u>

The following table presents the changes in the carrying amount of core deposit intangible, gross carrying amount, accumulated amortization, and net book value:

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
Balance at the beginning of the year	\$ 3,038	\$ 3,671
Amortization	(605)	(633)
Additions	—	—
Net Carrying Value	<u>\$ 2,433</u>	<u>\$ 3,038</u>
Gross carrying amount	\$ 5,932	\$ 5,932
Accumulated amortization	(3,499)	(2,894)
Net Carrying Value	<u>\$ 2,433</u>	<u>\$ 3,038</u>

Aggregate amortization expense was \$605,000, \$633,000 and \$1.7 million for 2013, 2012 and 2011, respectively.

Estimated amortization expense for each of the next five years is as follows:

2014	\$	578
2015		551
2016		523
2017		496
2018		285

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**NOTE 8—DEPOSITS**

Composition of deposits are as follows:

	December 31,	
	2013	2012
Noninterest-bearing demand deposits	\$ 126,680	\$ 134,597
Savings deposits	149,602	144,726
Money market accounts	347,017	349,092
Interest-bearing NOW accounts	353,787	348,683
Certificates of deposit	275,622	305,253
	\$ 1,252,708	\$ 1,282,351

Certificates of deposit of \$100,000 or more were \$90.5 million and \$97.0 million at December 31, 2013 and 2012, respectively.

Scheduled maturities of certificates of deposit for the next five years are as follows:

2014	\$ 203,419
2015	46,788
2016	17,510
2017	4,897
2018	3,008

**NOTE 9—BORROWINGS**

Year end borrowed funds are as follows:

	December 31,			
	2013		2012	
	Contractual Rate	Amount	Contractual Rate	Amount
Fixed-rate advance from FHLBC due - Within 1 year	—%	\$ —	2.99%	\$ 3,000
Securities sold under agreements to repurchase	0.25	3,055	0.25	2,567
	0.25%	\$ 3,055	1.73%	\$ 5,567

The Company maintains a collateral pledge agreement covering secured advances whereby the Company has agreed to keep on hand, free of all other pledges, liens, and encumbrances, specifically identified whole first mortgages on improved residential property not more than 90-days delinquent to secure advances from the FHLBC. All of the Bank's FHLBC common stock is pledged as additional collateral for these advances. At December 31, 2013, \$192.8 million and \$203.0 million of first mortgage and multi-family mortgage loans, respectively, collateralized potential advances. At December 31, 2013, we had the ability to borrow an additional \$251.4 million under our credit facilities with the FHLBC. The Company also had available pre-approved overnight federal funds borrowing. At December 31, 2013 and 2012, there was no outstanding balance on these lines.

Securities sold under agreements to repurchase were secured by mortgage-backed securities with a carrying amount of \$8.0 million and \$9.4 million at December 31, 2013 and 2012, respectively.

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**NOTE 10 – INCOME TAXES**

The income tax expense is as follows:

	<b>For the years ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
Current	\$ —	\$ —	\$ (6)
Deferred benefit	(1,310)	(11,206)	(10,220)
Deferred tax valuation allowance	1,310	11,206	22,601
Total income tax expense	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 12,375</u>

A reconciliation of the provision for income taxes computed at the statutory federal corporate tax rate of 34% for 2013, 2012 and 2011 to the income tax expense in the consolidated statements of operations follows:

	<b>For the years ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
Benefit computed at the statutory federal tax rate	\$ 1,121	\$ (9,217)	\$ (12,349)
State taxes and other, net	92	(1,757)	(1,395)
Tax adjustments	(2,390)	—	—
Bank owned life insurance	(106)	(149)	(213)
ESOP/Share based compensation	(27)	(83)	(144)
Goodwill impairment	—	—	4,271
Purchase price accounting adjustments	—	—	(396)
Deferred tax valuation allowance	1,310	11,206	22,601
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 12,375</u>
Effective income tax rate	—%	—%	N.M. <sup>(1)</sup>

Retained earnings at December 31, 2013 and 2012 include \$14.9 million for which no deferred federal income tax liability has been recorded. This amount represents an allocation of income to bad debt deductions for tax purposes alone.

- (1) The effective tax rate for the year ended December 31, 2011 is not meaningful due to the size of our operating loss relative to the income expense resulting from the deferred tax valuation allowance.

**BANKFINANCIAL CORPORATION**  
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**NOTE 10 – INCOME TAXES** (continued)

The net deferred tax asset is as follows:

	December 31,	
	2013	2012
<b>Gross Deferred tax assets</b>		
Allowance for loan losses	\$ 5,567	\$ 7,037
Alternative minimum tax, general business credit and net operating loss carryforward	30,311	25,040
Tax deductible goodwill	2,148	2,425
Accumulated depreciation	263	—
OREO valuation adjustments	714	2,989
Other	1,490	1,208
	<u>40,493</u>	<u>38,699</u>
<b>Gross Deferred tax liabilities</b>		
Net deferred loan origination costs	(1,426)	(1,164)
Purchase accounting adjustments	(2,552)	(1,423)
Accumulated depreciation	—	(465)
Mortgage servicing rights	(364)	(398)
Other	(600)	(739)
Unrealized gain on securities	(434)	(703)
	<u>(5,376)</u>	<u>(4,892)</u>
Valuation allowance	<u>(35,117)</u>	<u>(33,807)</u>
	<u>\$ —</u>	<u>\$ —</u>

A deferred tax asset valuation allowance is required to be recognized if it is “more likely than not” that the deferred tax asset will not be realized. The determination of the realizability of the deferred tax assets is highly subjective and dependent upon judgment concerning management’s evaluation of both positive and negative evidence, the forecasts of future taxable income, applicable tax planning strategies, and assessments of current and future economic and business conditions. The Company considered both positive and negative evidence regarding the ultimate realizability of its deferred tax assets. Examples of positive evidence may include the existence, if any, of taxes paid in available carry-back years and the likelihood that taxable income will be generated in future periods. Examples of negative evidence may include a cumulative loss in the current year and prior two years and negative general business and economic trends. In assessing the realization of deferred tax assets at December 31, 2013 and 2012, the Company concluded that it was more likely than not that the Company will not realize the benefits of these deductible differences at December 31, 2013 and 2012, and therefore, a full valuation allowance for deferred tax assets was recorded in the amount of \$35.1 million and \$33.8 million at December 31, 2013 and 2012, respectively.

At December 31, 2013, the Company had a federal net operating loss carryforward of \$60.4 million, which will begin to expire in 2029, a federal tax credit carryforward of \$1.3 million which will begin to expire in 2022, a \$2.5 million alternative minimum tax credit carryforward that can be carried forward indefinitely, and a \$53.6 million federal alternative minimum tax net operating loss carryforward which will begin to expire in 2031. In addition, at December 31, 2013 the Company had a federal net operating loss carryforward relating to its acquisition of Downers Grove National Bank, which is subject to utilization limitations under Section 382 of the Internal Revenue Code, of \$8.6 million which will begin to expire in 2030. At December 31, 2013, the Company had a state net operating loss carryforward for the State of Illinois of \$96.9 million, which will begin to expire in 2025.

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**NOTE 10 – INCOME TAXES** (continued)Unrecognized Tax Benefits

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	<b>December 31,</b>	
	<b>2013</b>	<b>2012</b>
Beginning of year	\$ 125	\$ 223
Additions based on tax positions related to the current year	—	—
Additions for tax positions of prior years	2	18
Reductions due to the statute of limitations and reductions for tax positions of prior years	(62)	(116)
End of year	<u>\$ 65</u>	<u>\$ 125</u>

The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months. The Company recognizes interest and/or penalties related to income tax matters in income tax expense. At December 31, 2013 and 2012, the Company has immaterial amounts accrued for potential interest and penalties.

The Company and its subsidiary are subject to U.S. federal income tax as well as income tax of the States of Illinois, New Jersey, Colorado, Minnesota and Texas. Beginning in 2013, the Bank became subject to income taxes in the States of Minnesota and Texas due to the physical presence of Wholesale Commercial bankers in these jurisdictions. The Company is no longer subject to examination by the federal taxing authorities for years before 2010 and the Illinois taxing authorities for years before 2010.

**NOTE 11– REGULATORY MATTERS**

The Bank is subject to regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by the Office of the Comptroller of the Currency that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by regulators about components, risk weightings, and other factors. The prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. Adequately capitalized institutions require regulatory approval to accept brokered deposits. If undercapitalized, a financial institution's capital distributions, asset growth and expansion are limited, and for the submission of a capital restoration is required.



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**NOTE 11– REGULATORY MATTERS (continued)**

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

	Actual		Minimum required To Be Well Capitalized Under Prompt Corrective Action Provisions		Minimum Capital Ratios Established under Capital Plans	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2013</b>						
Total capital (to risk-weighted assets):						
Consolidated	\$ 186,251	17.28%	\$ 86,212	8.00%	N/A	N/A
BankFinancial, F.S.B.	160,839	14.93	86,192	8.00	\$ 129,288	12.00%
Tier 1 (core) capital (to risk-weighted assets):						
Consolidated	172,775	16.03	43,106	4.00	N/A	N/A
BankFinancial, F.S.B.	147,363	13.68	43,096	4.00	86,192	8.00
Tier 1 (core) capital (to adjusted average total assets)						
Consolidated	172,775	11.92	58,002	4.00	N/A	N/A
BankFinancial, F.S.B.	147,363	10.16	57,992	4.00	115,984	8.00
<b>December 31, 2012</b>						
Total capital (to risk-weighted assets):						
Consolidated	\$ 181,404	18.01%	\$ 80,573	8.00%	N/A	N/A
BankFinancial, F.S.B.	154,296	15.32	80,553	8.00	\$ 120,830	12.00%
Tier 1 (core) capital (to risk-weighted assets):						
Consolidated	168,734	16.75	40,287	4.00	N/A	N/A
BankFinancial, F.S.B.	141,629	14.07	40,277	4.00	80,553	8.00
Tier 1 (core) capital (to adjusted average total assets)						
Consolidated	168,734	11.43	59,054	4.00	N/A	N/A
BankFinancial, F.S.B.	141,629	9.60	59,029	4.00	118,058	8.00

A reconciliation of the Bank's equity under GAAP to regulatory capital is as follows:

	December 31,	
	2013	2012
GAAP equity	\$ 150,215	\$ 145,785
Disallowed goodwill and other intangible assets	(2,433)	(3,038)
Accumulated other comprehensive income (unrealized gain on securities)	(419)	(1,118)
Tier 1 capital	147,363	141,629
General regulatory loan loss reserves allowed	13,476	12,654
Unrealized gains on securities available for sale allowed	—	13
Total regulatory capital	<u>\$ 160,839</u>	<u>\$ 154,296</u>

As of December 31, 2013 and 2012, the OCC categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since those notifications that management believes have changed the institution's well-capitalized status.

The Company and the Bank have adopted Capital Plans that requires the Bank to maintain a Tier 1 leverage ratio of at least 8% and a total risk-based capital ratio of at least 12%. The minimum capital ratios set forth in the Capital Plans will be increased and other minimum capital requirements will be established if and as necessary to comply with the Basel III requirements as such requirements become applicable to the Company and the Bank. In accordance with the Capital Plans, neither the Company nor the Bank will

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**NOTE 11– REGULATORY MATTERS (continued)**

pursue any acquisition or growth opportunity, declare any dividend or conduct any stock repurchase that would cause the Bank’s total risk-based capital ratio and/or its Tier 1 leverage ratio to fall below the established minimum capital levels. In addition, the Company will continue to maintain its ability to serve as a source of financial strength to the Bank by holding at least \$5.0 million of cash or liquid assets for that purpose.

Federal regulations require the Bank to comply with a Qualified Thrift Lender (“QTL”) test, which generally requires that 65% of assets be maintained in housing-related finance and other specified assets. If the QTL test is not met, limits are placed on growth, branching, new investment, FHLBC advances, and dividends or the institution must convert to a commercial bank charter. Management considers the QTL test to have been met as of December 31, 2013.

The Bank is subject to restrictions on the amount of dividends it may declare and pay to the Company without prior regulatory approval. At December 31, 2013, the Bank does not have pre-approved approval for future dividends.

**NOTE 12 – EMPLOYEE BENEFIT PLANS**

**Employee Stock Ownership Plan.** 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 shares of common stock issued in the subscription offering at \$10.00 per share. The loan is secured by the shares 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. When loan payments are made, ESOP shares are allocated to participants based on relative compensation and expense is recorded. Participants receive their earned shares at the end of employment.

Contributions to the ESOP were \$1.5 million for the years ended December 31, 2013 and 2012, including dividends and interest received on unallocated shares of \$49,000 and \$40,000 in 2013 and 2012, respectively.

Expense related to the ESOP, net of dividends and interest received on unallocated ESOP shares, was \$847,000, \$686,000 and \$228,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

Shares held by the ESOP were as follows:

	December 31,	
	2013	2012
Allocated to participants	725,781	654,690
Distributed to participants	(33,512)	(26,774)
Unearned	1,125,447	1,223,312
Total ESOP shares	1,817,716	1,851,228
Fair value of unearned shares	\$ 10,309	\$ 9,077

**Profit Sharing Plan/401(k) Plan.** The Company has a defined contribution plan (“profit sharing plan”) covering all of its eligible employees. Employees are eligible to participate in the profit sharing plan after attainment of age 21 and completion of one year of service. The Company provides a match of \$0.50 on each \$1.00 of contribution up to 6% of eligible compensation beginning April 1, 2007. The Company may also contribute an additional amount annually at the discretion of the Board of Directors. Contributions totaling \$346,000, \$384,000, and \$396,000 were made for the years ended December 31, 2013, 2012 and 2011, respectively.

**NOTE 13 – EQUITY INCENTIVE PLANS**

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

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

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**NOTE 13 – EQUITY INCENTIVE PLANS** (continued)

of the grants. The stock options generally vest annually over 3 to 5 year periods; vesting is subject to acceleration in certain circumstances. The stock options will expire if not exercised within 5 years from the date of grant.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. The risk-free interest rate was determined using the yield available on the option grant date for a zero-coupon U.S. Treasury security with a term equivalent to the expected life of the option. The expected life for options granted represents the period the option is expected to be outstanding and was determined by applying the simplified method as allowed by SAB 107. The expected volatility for options issued in 2009 was determined using the Company's historical data. Estimated forfeitures were assumed to be zero due to the lack of historical experience for the Company. There were no options granted in 2013 or 2012.

The Company recognized \$12,000 of stock-based compensation expenses relating to the granting of stock options for the year ended December 31, 2011. There was no expense recorded for the years ended December 31, 2013, and 2012.

On September 2, 2011, the Human Resources Committee and the Board of Directors of the Company approved a one year extension of stock options granted in prior years that were scheduled to expire in September and December of 2011. After the extensions, the stock options expired in September and December of 2012. The extensions only involved the expiration date of the stock options and do not affect their other terms. There was no expense recorded with the extension of the options. The extended stock options provided the holders with an option to purchase 1,858,403 shares of the Company's common stock at a weighted average exercise price of \$16.62. As of December 31, 2013 and 2012, there were no stock options outstanding.

Stock Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value <sup>(1)</sup>
Stock options outstanding at December 31, 2011	2,075,553	\$ 16.54	0.7	\$ —
Stock options granted	—	—		
Stock options exercised	—	—		
Stock options expired	(2,064,553)	(16.54)		
Stock options forfeited	(11,000)	—		
Stock options outstanding at December 31, 2012	—	\$ —	—	\$ —
Stock options outstanding at December 31, 2013	—	\$ —	—	\$ —
Fully vested and expected to vest	—	\$ —	—	\$ —

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

The Human Resources Committee of the Board of Directors may grant shares of restricted stock to certain employees and directors of the Company. The awards generally vest annually over varying periods from three to five years and vesting is subject to acceleration in certain circumstances. The cost of such awards will be accrued ratably as compensation expense over such respective periods based on expected vesting dates. The Company recognized \$86,000, \$41,000, and \$41,000 of expenses relating to the grant of shares of restricted stock during the years ended December 31, 2013, 2012 and 2011, respectively. As of December 31, 2013, the total unrecognized compensation cost related to unvested shares of restricted stock was \$150,000. The cost is expected to be recognized over a weighted average period of 18 months.

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**NOTE 13 – EQUITY INCENTIVE PLANS (continued)**

Restricted Stock	Number of Shares <sup>(1)</sup>	Weighted Average Fair Value at Grant Date	Weighted Average Term to Vest (in years)	Aggregate Intrinsic Value <sup>(2)</sup>
Shares outstanding at December 31, 2011	4,334	\$ 9.54	0.5	\$ 24
Shares granted	—	—		
Shares vested	(4,334)	(9.54)		
Shares forfeited	—	—		
Shares outstanding at December 31, 2012	—	—	—	\$ —
Shares granted	29,000	8.14		
Shares vested	(3,250)	—		
Shares forfeited	—	—		
Shares outstanding at December 31, 2013	<u>25,750</u>	<u>\$ 8.14</u>	1.2	\$ 236

(1) The end of period balances consist only of unvested shares.

(2) Restricted stock aggregate intrinsic value represents the number of shares of restricted stock multiplied by the market price of the common stock underlying the outstanding shares on the date shown.

**NOTE 14 – LOAN COMMITMENTS AND OTHER OFF-BALANCE SHEET ACTIVITIES**

The Company is party to various financial instruments with off-balance-sheet risk. The Company uses these financial instruments in the normal course of business to meet the financing needs of customers and to effectively manage exposure to interest rate risk. These financial instruments include commitments to extend credit, standby letters of credit, unused lines of credit, and commitments to sell loans. When viewed in terms of the maximum exposure, those instruments may involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated statements of financial condition. Credit risk is the possibility that a counterparty to a financial instrument will be unable to perform its contractual obligations. Interest rate risk is the possibility that, due to changes in economic conditions, the Company's net interest income will be adversely affected.

The following is a summary of the contractual or notional amount of each significant class of off-balance-sheet financial instruments outstanding. The Company's exposure to credit loss in the event of nonperformance by the counterparty for commitments to extend credit, standby letters of credit, and unused lines of credit is represented by the contractual notional amount of these instruments.

The contractual or notional amounts are as follows:

	December 31,	
	2013	2012
Financial instruments wherein contractual amounts represent credit risk		
Commitments to extend credit	\$ 29,253	\$ 15,971
Standby letters of credit	922	1,237
Unused lines of credit	118,167	120,733
Commitments to sell mortgages	222	1,268

Commitments to extend credit are generally made for periods of 60 days or less. The fixed-rate loans commitment totaled \$17.3 million with interest rates ranging from 2.25% to 5.04% and maturities ranging from 1 to 30 years.

Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customers. The collateral held varies, but primarily consists of single-family residential real estate.

The Bank, as a member of Visa USA, received 51,404 unrestricted shares of Visa, Inc. Class B common stock in connection with Visa, Inc.'s initial public offering in 2007, and 32,398 additional shares of Class B common stock that were deposited into a

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**NOTE 14 – LOAN COMMITMENTS AND OTHER OFF-BALANCE SHEET ACTIVITIES (continued)**

litigation escrow that Visa, Inc. established under its retrospective responsibility plan. The retroactive responsibility plan obligates all former Visa USA members to indemnify Visa USA, in proportion to their equity interests in Visa USA, for certain litigation losses and expenses, including settlement expenses, for the lawsuits covered by the retrospective responsibility plan. The primary method for discharging the indemnification obligations under the retrospective responsibility plan is a reduction of the ratio at which the Visa, Inc. Class B shares held in the litigation escrow can be converted into publicly traded Class A common shares of Visa, Inc. Due to the restrictions that the retrospective responsibility plan imposes on the Company's Visa, Inc. Class B shares, the Company has not recorded the Class B shares as an asset.

**NOTE 15 – FAIR VALUE**

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

- Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3 – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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

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

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

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

**Other Real Estate Owned:** Assets acquired through foreclosure or transfers in lieu of foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. Although the fair value of the property normally will be based on an appraisal (or other evaluation), the valuation should be consistent with the price that a market participant will pay to purchase the property at the measurement date. Circumstances may exist that indicate that the appraised

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**NOTE 15 – FAIR VALUE** (continued)

value is not an accurate measurement of the property's current fair value. Examples of such circumstances include changed economic conditions since the last appraisal, stale appraisals, or imprecision and subjectivity in the appraisal process (i.e., actual sales for less than the appraised amount). Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

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

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

	Fair Value Measurements Using			Fair Value
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>December 31, 2013</b>				
Securities:				
Certificates of deposit	\$ —	\$ 65,010	\$ —	\$ 65,010
Municipal securities	—	187	—	187
Equity mutual fund	497	—	—	497
Mortgage-backed securities – residential	—	28,364	—	28,364
Collateralized mortgage obligations – residential	—	16,814	—	16,814
SBA-guaranteed loan participation certificates	—	35	—	35
	<u>\$ 497</u>	<u>\$ 110,410</u>	<u>\$ —</u>	<u>\$ 110,907</u>
<b>December 31, 2012</b>				
Securities:				
Certificates of deposit	\$ —	33,456	\$ —	\$ 33,456
Municipal securities	—	369	—	369
Equity mutual fund	528	—	—	528
Mortgage-backed securities - residential	—	34,233	—	34,233
Collateralized mortgage obligations – residential	—	9,204	—	9,204
SBA-guaranteed loan participation certificates	—	42	—	42
	<u>\$ 528</u>	<u>\$ 77,304</u>	<u>\$ —</u>	<u>\$ 77,832</u>

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**NOTE 15 – FAIR VALUE** (continued)

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

	Fair Value Measurement Using			Fair Value
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>December 31, 2013</b>				
Impaired loans:				
One-to-four family residential real estate	\$ —	\$ —	\$ 460	\$ 460
Multi-family mortgage	—	—	2,286	2,286
Nonresidential real estate	—	—	971	971
Construction and land loans	—	—	107	107
Impaired loans	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 3,824</u>	<u>\$ 3,824</u>
Other real estate owned:				
One-to-four family residential real estate	\$ —	\$ —	\$ 297	\$ 297
Nonresidential real estate	—	—	460	460
Land	—	—	1,019	1,019
Other real estate owned	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1,776</u>	<u>\$ 1,776</u>
Mortgage servicing rights				
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 198</u>	<u>\$ 198</u>
<b>December 31, 2012</b>				
Impaired loans:				
One-to-four family residential real estate	\$ —	\$ —	\$ 410	\$ 410
Multi-family mortgage	—	—	1,916	1,916
Nonresidential real estate	—	—	3,102	3,102
Construction and land	—	—	2,841	2,841
Commercial loans	—	—	181	181
Impaired loans	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 8,450</u>	<u>\$ 8,450</u>
Other real estate owned:				
One-to-four family residential real estate	\$ —	\$ —	\$ 1,503	\$ 1,503
Multi-family mortgage	—	—	720	720
Nonresidential real estate	—	—	3,649	3,649
Land	—	—	3,496	3,496
Other real estate owned	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 9,368</u>	<u>\$ 9,368</u>
Mortgage servicing rights				
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 208</u>	<u>\$ 208</u>

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**NOTE 15 – FAIR VALUE** (continued)

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral-dependent loans, had a carrying amount of \$4.2 million, with a valuation allowance of \$375,000 at December 31, 2013, compared to a carrying amount of \$10.1 million and a valuation allowance of \$1.7 million at December 31, 2012, resulting in a decrease in the provision for loan losses of \$1.3 million for the year ended December 31, 2013.

OREO is carried at the lower of cost or fair value less costs to sell, had a carrying value of \$2.7 million less a valuation allowance of \$902,000, or \$1.8 million at December 31, 2013, compared to \$10.5 million less a valuation allowance of \$1.2 million, or \$9.4 million at December 31, 2012. There were \$550,000 of valuation adjustments of other real estate owned recorded for the year ended December 31, 2013.

Mortgage servicing rights, which are carried at lower of cost or fair value, had a carrying amount of \$198,000 at December 31, 2013, and \$208,000 at December 31, 2012. A pre-tax recovery of \$65,000 on our mortgage servicing rights portfolio was included in noninterest income for the year ended December 31, 2013, compared to a \$55,000 provision for the same period in 2012.



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**NOTE 15 – FAIR VALUE** (continued)

The following table presents quantitative information, based on certain empirical data with respect to Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2013:

	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
<b>Impaired loans</b>				
One-to-four family residential real estate	\$ 460	Sales comparison	Discount applied to valuation	7.5%-12.8% (10%)
Multi-family mortgage	2,286	Sales comparison	Comparison between sales and income approaches	12.3%-19.4% (17%)
		Income approach	Cap Rate	7.25% to 13.8% (9%)
Nonresidential real estate	971	Sales comparison	Comparison between sales and income approaches	-3.0%-45.1% (11%)
		Income approach	Cap Rate	10%-10.7% (10%)
Construction and land loans	107	Sales comparison	Discount applied to valuation	21.2%
	<u>\$ 3,824</u>			
<b>Other real estate owned</b>				
One-to-four family residential real estate	\$ 297	Sales comparison	Discount applied to valuation	5.0%-9.4% (8%)
Nonresidential real estate	460	Sales comparison	Comparison between sales and income approaches	0%-10.1% (7%)
Land	1,019	Sales comparison	Discount applied to valuation	0%-10.2% (2%)
	<u>\$ 1,776</u>			
Mortgage servicing rights	\$ 198	Third party valuation	Present value of future servicing income based on prepayment speeds	11.4 % - 23.5% (15.21%)
		Third party valuation	Present value of future servicing income based on default rates	12%

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**NOTE 15 – FAIR VALUE** (continued)

The following table presents quantitative information, based on certain empirical data with respect to Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2012:

	<u>Fair Value</u>	<u>Valuation Technique(s)</u>	<u>Unobservable Input(s)</u>	<u>Range (Weighted Average)</u>
<b>Impaired loans</b>				
One-to-four family residential real estate	\$ 410	Sales comparison	Discount applied to valuation	6%-90% (58%)
Multi-family mortgage	1,916	Sales comparison	Comparison between sales and income approaches	2%-95% (42%)
		Income approach	Cap Rate	8.3% to 9.5% (8.95%)
Nonresidential real estate	3,102	Sales comparison	Comparison between sales and income approaches	6%-99% (61%)
		Income approach	Cap Rate	8% to 10% (8.61%)
Construction and land	2,841	Sales comparison	Discount applied to valuation	-3% to 53% (22%)
Commercial loans	181	Sales comparison	Discount applied to valuation	0%-11% (43%)
	<u>\$ 8,450</u>			
<b>Other real estate owned</b>				
One-to-four family residential real estate	\$ 1,503	Sales comparison	Discount applied to valuation	7%-78% (17%)
Multi-family mortgage	720	Sales comparison	Comparison between sales and income approaches	13%-62% (42%)
			Comparison between sales and income approaches	7%-37% (27%)
Nonresidential real estate	3,649	Sales comparison	Comparison between sales and income approaches	7%-37% (27%)
Land	3,496	Sales comparison	Discount applied to valuation	7%-21% (10%)
	<u>\$ 9,368</u>			
Mortgage servicing rights	\$ 208	Third party valuation	Present value of future servicing income based on prepayment speeds	12.7% - 28.6% (18.62%)
		Third party valuation	Present value of future servicing income based on default rates	12%

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**NOTE 15 – FAIR VALUE** (continued)

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

	Carrying Amount	Fair Value Measurements at December 31, 2013 Using:			Total
		Level 1	Level 2	Level 3	
<b>Financial assets</b>					
Cash and cash equivalents	\$ 160,957	\$ 15,781	\$ 145,176	\$ —	\$ 160,957
Securities	110,907	497	110,410	—	110,907
Loans receivable, net of allowance for loan losses	1,098,077	—	1,049,111	3,824	1,052,935
FHLBC stock	6,068	—	—	—	N/A
Accrued interest receivable	3,933	—	3,933	—	3,933
<b>Financial liabilities</b>					
Noninterest-bearing demand deposits	\$ 126,680	\$ —	\$ 126,680	\$ —	\$ 126,680
Savings deposits	149,602	—	149,602	—	149,602
NOW and money market accounts	700,804	—	700,804	—	700,804
Certificates of deposit	275,622	—	276,022	—	276,022
Borrowings	3,055	—	3,057	—	3,057
Accrued interest payable	113	—	113	—	113

	Carrying Amount	Fair Value Measurements at December 31, 2012 Using:			Total
		Level 1	Level 2	Level 3	
<b>Financial assets</b>					
Cash and cash equivalents	\$ 275,764	\$ 20,361	\$ 255,403	\$ —	\$ 275,764
Securities	77,832	528	77,304	—	77,832
Loans held-for-sale	2,166	—	2,166	—	2,166
Loans receivable, net of allowance for loan losses	1,030,465	—	1,017,637	8,450	1,026,087
FHLBC stock	8,412	—	—	—	N/A
Accrued interest receivable	4,146	—	4,146	—	4,146
<b>Financial liabilities</b>					
Noninterest-bearing demand deposits	\$ 134,597	\$ —	\$ 134,597	\$ —	\$ 134,597
Savings deposits	144,726	—	144,726	—	144,726
NOW and money market accounts	697,775	—	697,775	—	697,775
Certificates of deposit	305,253	—	306,859	—	306,859
Borrowings	5,567	—	5,608	—	5,608
Accrued interest payable	157	—	157	—	157

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

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

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**NOTE 15 – FAIR VALUE** (continued)

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

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

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

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

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

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

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

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

**NOTE 16 – COMPANY ONLY CONDENSED FINANCIAL INFORMATION**

Condensed financial information of BankFinancial Corporation as of December 31, 2013 and 2012 and for the three years ended December 31, 2013 follows:

**Condensed Statements of Financial Condition**

	December 31,	
	2013	2012
<b>Assets</b>		
Cash in subsidiary	\$ 11,441	\$ 11,848
Loan receivable from ESOP	13,742	14,654
Investment in subsidiary	150,215	145,785
Income tax receivable	—	461
Other assets	252	163
	<u>\$ 175,650</u>	<u>\$ 172,911</u>
<b>Liabilities and Stockholders' Equity</b>		
Accrued expenses and other liabilities	23	21
Total stockholders' equity	175,627	172,890
	<u>\$ 175,650</u>	<u>\$ 172,911</u>

**BANKFINANCIAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Table amounts in thousands, except share and per share data)

**NOTE 16 – COMPANY ONLY CONDENSED FINANCIAL INFORMATION** (continued)**Condensed Statements of Operations**

	<b>For the years ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
Interest income	\$ 623	\$ 662	\$ 696
Other income	—	57	—
Other expense	1,473	1,422	1,381
Loss before income tax and undistributed subsidiary income	(850)	(703)	(685)
Income tax expense	—	—	254
Loss before equity in undistributed subsidiary income	(850)	(703)	(939)
Equity in undistributed subsidiary excess distributions	4,148	(26,406)	(47,757)
<b>Net income (loss)</b>	<b>\$ 3,298</b>	<b>\$ (27,109)</b>	<b>\$ (48,696)</b>

**Condensed Statements of Cash Flows**

	<b>For the years ended December 31,</b>		
	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities</b>			
Net income (loss)	\$ 3,298	\$ (27,109)	\$ (48,696)
Adjustments:			
Equity in undistributed subsidiary excess distributions	(4,148)	26,406	47,757
Change in other assets	373	1,143	350
Change in accrued expenses and other liabilities	2	(780)	(89)
Net cash used in operating activities	(475)	(340)	(678)
<b>Cash flows from investing activities</b>			
Principal payments received on ESOP loan	912	873	840
Net cash from investing activities	912	873	840
<b>Cash flows from financing activities</b>			
Cash dividends paid on common stock	(844)	(633)	(4,636)
Net cash used in financing activities	(844)	(633)	(4,636)
Net change in cash in subsidiary	(407)	(100)	(4,474)
Beginning cash in subsidiary	11,848	11,948	16,422
<b>Ending cash in subsidiary</b>	<b>\$ 11,441</b>	<b>\$ 11,848</b>	<b>\$ 11,948</b>

**BANKFINANCIAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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

**NOTE 17 – SELECTED QUARTERLY FINANCIAL DATA (unaudited)**

	<b>For the year ended December 31, 2013</b>			
	<b>First Quarter</b>	<b>Second Quarter</b>	<b>Third Quarter</b>	<b>Fourth Quarter</b>
Interest income	\$ 12,713	\$ 12,276	\$ 12,107	\$ 12,296
Interest expense	994	935	882	842
Net interest income	11,719	11,341	11,225	11,454
Provision for (recovery of) loan losses	722	206	(437)	(1,178)
Net interest income	10,997	11,135	11,662	12,632
Noninterest income	3,029	1,703	1,737	1,665
Noninterest expense	13,348	12,762	12,360	12,792
Income before income taxes	678	76	1,039	1,505
Income tax expense (benefit)	—	—	—	—
Net income	\$ 678	\$ 76	\$ 1,039	\$ 1,505
Basic earnings per common share	\$ 0.03	\$ —	\$ 0.05	\$ 0.08
Diluted earnings per common share	\$ 0.03	\$ —	\$ 0.05	\$ 0.08

The Company recorded net income of \$1.5 million for the fourth quarter of 2013. The Company's net interest income before provision for loan losses increased to \$11.5 million due to stronger loan originations and improved asset quality. The Company's fourth quarter 2013 operating results included a \$1.2 million recovery of loan losses. The recovery is primarily due to the growth in our loan portfolio was focused on loan types with lower loss ratios based on our historical loss experience and the historical loan loss factors improved as the losses incurred in earlier periods aged, therefore are weighted less in the calculation. Noninterest expense included \$811,000 of nonperforming asset management and OREO expense.

	<b>For the year ended December 31, 2012</b>			
	<b>First Quarter</b>	<b>Second Quarter</b>	<b>Third Quarter</b>	<b>Fourth Quarter</b>
Interest income	\$ 16,634	\$ 15,824	\$ 14,468	\$ 13,801
Interest expense	1,240	1,112	1,036	1,059
Net interest income	15,394	14,712	13,432	12,742
Provision for loan losses	996	1,745	4,453	24,328
Net interest income	14,398	12,967	8,979	(11,586)
Noninterest income	2,044	1,641	2,054	1,984
Noninterest expense	13,648	14,267	16,255	15,420
Income (loss) before income taxes	2,794	341	(5,222)	(25,022)
Income tax expense (benefit)	457	(457)	—	—
Net income (loss)	\$ 2,337	\$ 798	\$ (5,222)	\$ (25,022)
Basic earnings (loss) per common share	\$ 0.12	\$ 0.04	\$ (0.26)	\$ (1.25)
Diluted earnings (loss) per common share	\$ 0.12	\$ 0.04	\$ (0.26)	\$ (1.25)

The Company recorded a net loss of \$25.0 million for the fourth quarter of 2012. The Company's fourth quarter 2012 operating results included a \$24.3 million provision for loan losses. In late 2012, the Company completed several actions to materially reduce future nonperforming asset expenses. The Company completed two bulk sales of certain nonperforming assets with a carrying value of \$22.7 million, reclassified \$7.5 million of loans as held-for-sale in preparation for a third bulk sale, and restructured \$7.1 million of performing classified loans to enable the basis for their classification to be resolved in 2013. These actions resulted in pre-tax charges of \$19.4 million. Noninterest expense included \$3.6 million of nonperforming asset management and OREO expense.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

Not Applicable.

**ITEM 9A. CONTROLS AND PROCEDURES**

(a) Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the fiscal year ( "Evaluation Date"). Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective.

(b) Management's Annual Report on Internal Control Over Financial Reporting.

The annual report of management on the effectiveness of our internal control over financial reporting and the attestation report thereon issued by our independent registered public accounting firm are set forth under "Report of Management on Internal Control Over Financial Reporting" and "Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting" under Item 8 - "Financial Statements and Supplementary Data."

(c) Changes in internal controls.

There were no changes made in our internal controls during the fourth quarter of 2013 or, to our knowledge, in other factors that have materially affected, or are reasonably likely to materially affect these controls.

See the Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

**ITEM 9B. OTHER INFORMATION**

Not Applicable.

**PART III**

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

**Directors and Executive Officers**

The information concerning our directors and executive officers required by this item will be filed with the Securities and Exchange Commission by amendment to this Form 10-K, not later than 120 days after the end of our fiscal year.

**Section 16(a) Beneficial Ownership Reporting Compliance**

The information concerning compliance with the reporting requirements of Section 16(a) of the Securities Exchange Act of 1934 by our directors, officers and 10 percent stockholders required by this item will be filed with the Securities and Exchange Commission by amendment to this Form 10-K, not later than 120 days after the end of our fiscal year.

**Code of Ethics**

We have adopted a Code of Ethics for Senior Financial Officers that applies to our principal executive officer, principal financial officer, principal accounting officer, and persons performing similar functions. A copy of our Code of Ethics was attached as Exhibit 14 to our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 27, 2006. We have also adopted a Code of Business Conduct, pursuant to NASDAQ requirements, that applies generally to our directors, officers, and employees.

**ITEM 11. EXECUTIVE COMPENSATION**

The information concerning compensation required by this item will be filed with the Securities and Exchange Commission by amendment to this Form 10-K, not later than 120 days after the end of our fiscal year.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information concerning security ownership of certain beneficial owners and management required by this item will be filed with the Securities and Exchange Commission by amendment to this Form 10-K, not later than 120 days after the end of our fiscal year.

**Securities Authorized for Issuance under Equity Compensation Plans**

The following table sets forth information regarding the securities that were authorized for issuance under our 2006 Equity Incentive Plan as of December 31, 2013:

Plan Category	Column (A)	Column (B)	Column (B)
	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance under 2006 Equity Incentive Plan (Excluding Securities Reflected in Column (A))
Equity compensation plans approved by stockholders	25,750	—	3,425,275
Equity compensation plans not approved by stockholders	—	—	—
Total	25,750	—	3,425,275

Column (A) represents stock options and restricted stock outstanding under the Company's 2006 Equity Incentive Plan. Future equity awards under the 2006 Equity Incentive Plan may take the form of stock options, stock appreciation rights, performance unit awards, restricted stock, restricted performance stock, restricted stock units, stock awards or cash. Column (B) represents the weighted-average exercise price of the outstanding stock options only; the outstanding restricted stock awards are not included in this calculation. Column (C) represents the maximum aggregate number of future equity awards that can be made under the 2006 Equity Incentive Plan as of December 31, 2013.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information concerning certain relationships and related transactions required by this will be filed with the Securities and Exchange Commission by amendment to this Form 10-K, not later than 120 days after the end of our fiscal year.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information concerning principal accountant fees and services will be filed with the Securities and Exchange Commission by amendment to this Form 10-K, not later than 120 days after the end of our fiscal year.

**PART IV****ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES****(a)(1) Financial Statements**

The following consolidated financial statement of the registrant and its subsidiaries are filed as part of this document under Item 8 - "Financial Statements and Supplementary Data."

- (A) Report of Independent Registered Accounting Firm
- (B) Consolidated Statements of Financial Condition - at December 31, 2013 and 2012
- (C) Consolidated Statements of Operations for the years ended December 31, 2013, 2012 and 2011
- (D) Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2013, 2012 and 2011
- (E) Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2013, 2012 and 2011
- (F) Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012 and 2011
- (G) Notes to Consolidated Financial Statements



(a)(2) Financial Statement Schedules

None.

(a)(3) Exhibits

The documents set forth below are filed herewith or incorporated herein by reference to the location indicated.

<u>Exhibit</u>	<u>Location</u>	
3.1	Articles of Incorporation of BankFinancial Corporation	Exhibit 3.1 to the Registration Statement on Form S-1 of the Company, originally filed with the Securities and Exchange Commission on September 23, 2004
3.2	Bylaws of BankFinancial Corporation	Exhibit 3.2 to the Registration Statement on Form S-1 of the Company, originally filed with the Securities and Exchange Commission on September 23, 2004
3.3	Articles of Amendment to Charter of BankFinancial Corporation	Exhibit 3.3 to the Registration Statement on Form S-1 of the Company, originally filed with the Securities and Exchange Commission on September 23, 2004
3.4	Restated Bylaws of BankFinancial Corporation	Exhibit 3.4 to the Annual Report on Form 10-K of the Company, originally filed with the Securities and Exchange Commission on March 15, 2007
4	Form of Common Stock Certificate of BankFinancial Corporation	Exhibit 4 to the Registration Statement on Form S-1 of the Company, originally filed with the Securities and Exchange Commission on September 23, 2004
10.1	Employee Stock Ownership Plan	Exhibit 10.1 to the Registration Statement on Form S-1 of the Company, originally filed with the Securities and Exchange Commission on September 23, 2004
10.2	Deferred Compensation Plan	Exhibit 10.2 to the Registration Statement on Form S-1 of the Company, originally filed with the Securities and Exchange Commission on September 23, 2004
10.3	BankFinancial FSB Employment Agreement with F. Morgan Gasior	Exhibit 10.1 to the Current Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on May 5, 2008
10.4	BankFinancial FSB Employment Agreement with James J. Brennan	Exhibit 10.3 to the Current Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on May 5, 2008.
10.5	BankFinancial FSB Employment Agreement with Paul A. Cloutier	Exhibit 10.2 to the Current Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on May 5, 2008
10.6	BankFinancial FSB Employment Agreement with Christa N Calabrese	Exhibit 10.5 to the Current Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on May 5, 2008
10.12	Form of Incentive Stock Option Award Terms	Exhibit 10.1 to the Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on September 5, 2006
10.13	2006 BankFinancial Corporation Equity Incentive Plan	Appendix C to the Definitive Form 14A, originally filed with the Securities and Exchange Commission on May 25, 2006 (File No. 000-51331)
10.14	Form of Performance Based Incentive Stock Option Award Terms	Exhibit 10.2 to the Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on September 5, 2006
10.15	Form of Non-Qualified Stock Option Award Terms	Exhibit 10.3 to the Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on September 5, 2006
10.16	Form of Performance Based Non-Qualified Stock Option Award Terms	Exhibit 10.4 to the Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on September 5, 2006

	<b>Exhibit</b>	<b>Location</b>
10.17	Form of Restricted Stock Unit Award Agreement	Exhibit 10.5 to the Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on September 5, 2006
10.18	Form of Performance Based Restricted Stock Award Agreement	Exhibit 10.6 to the Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on September 5, 2006
10.19	Form of Restricted Stock Award Agreement	Exhibit 10.7 to the Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on September 5, 2006
10.20	Form of Stock Appreciation Rights Agreement	Exhibit 10.8 to the Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on September 5, 2006
10.25	BankFinancial Corporation Employment Agreement with F. Morgan Gasior	Exhibit 10.1 to the Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on October 20, 2008
10.26	BankFinancial Corporation Employment Agreement with Paul A. Cloutier	Exhibit 10.2 to the Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on October 20, 2008
10.27	BankFinancial Corporation Employment Agreement with James J. Brennan	Exhibit 10.3 to the Report on Form 8-K of the Company, originally filed with the Securities and Exchange Commission on October 20, 2008.
10.28	BankFinancial Corporation Employment Agreement with Elizabeth A. Doolan	Exhibit 10.28 to the Annual Report on Form 10-K of the Company, originally filed with the Securities and Exchange Commission on February 23, 2009.
10.29	BankFinancial FSB Employment Agreement with Elizabeth A. Doolan	Exhibit 10.29 to the Annual Report on Form 10-K of the Company, originally filed with the Securities and Exchange Commission on February 23, 2009.
10.30	BankFinancial FSB Employment Agreement with Gregg T. Adams	Exhibit 10.30 to the Annual Report on Form 10-K/A of the Company originally filed with the Securities and Exchange Commission on April 30, 2010.
10.31	BankFinancial FSB Employment Agreement with John G. Manos	Exhibit 10.31 to the Annual Report on Form 10-K/A of the Company originally filed with the Securities and Exchange Commission on April 30, 2010.
10.32	BankFinancial FSB Employment Agreement with William J. Deutsch, Jr.	Exhibit 10.32 to the Annual Report on Form 10-K/A of the Company originally filed with the Securities and Exchange Commission on May 2, 2011.
10.33	Form of Amendment No. 1 to BankFinancial FSB Employment Agreement	Exhibit 10.33 to the Annual Report on Form 10-K of the Company, originally filed with the Securities and Exchange Commission on March 11, 2013
10.34	Form of Amendment No. 1 to BankFinancial FSB Employment Agreement	Exhibit 10.34 to the Annual Report on Form 10-K of the Company, originally filed with the Securities and Exchange Commission on March 11, 2013
10.35	Form of Amendment No. 1 to BankFinancial Corporation Employment Agreement	Exhibit 10.35 to the Annual Report on Form 10-K of the Company, originally filed with the Securities and Exchange Commission on March 11, 2013
14	Code of Ethics for Senior Financial Officers	Exhibit 14 to the Annual Report on Form 10-K of the Company, originally filed with the Securities and Exchange Commission on March 27, 2006
21	Subsidiaries of Registrant	Exhibit 21 to the Registration Statement on Form S-1 of the Company, originally filed with the Securities and Exchange Commission on September 23, 2004
23	Consent of Crowe Horwath LLP	Filed herewith
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith

	<b>Exhibit</b>	<b>Location</b>
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*	Furnished herewith
101	The following financial statements from the BankFinancial Corporation Quarterly Report on Form 10-K for the year ended December 31, 2013, formatted in Extensive Business Reporting Language (XBRL): (i) consolidated statement of conditions, (ii) consolidated statements of operations, (iii) consolidated statements of cash flows and (iv) the notes to consolidated financial statements.	Filed herewith

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

**SIGNATURES**

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

**BANKFINANCIAL CORPORATION**

Date: March 14, 2014

By: /s/ F. Morgan Gasior

F. Morgan Gasior

Chairman of the Board, Chief Executive Officer and President

(Duly Authorized Representative)

Pursuant to the requirements of the Securities Exchange of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<b>Signatures</b>	<b>Title</b>	<b>Date</b>
<u>/s/ F. Morgan Gasior</u> F. Morgan Gasior	Chairman of the Board, Chief Executive Officer and President (Principal Executive Officer)	March 14, 2014
<u>/s/ Paul A. Cloutier</u> Paul A. Cloutier	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	March 14, 2014
<u>/s/ Elizabeth A. Doolan</u> Elizabeth A. Doolan	Senior Vice President and Controller (Principal Accounting Officer)	March 14, 2014
<u>/s/ Cassandra J. Francis</u> Cassandra J. Francis	Director	March 14, 2014
<u>/s/ John M. Hausmann</u> John M. Hausmann	Director	March 14, 2014
<u>/s/ Thomas F. O'Neill</u> Thomas F. O'Neill	Director	March 14, 2014
<u>/s/ Joseph A. Schudt</u> Joseph A. Schudt	Director	March 14, 2014
<u>/s/ Terry R. Wells</u> Terry R. Wells	Director	March 14, 2014
<u>/s/ Glen R. Wherfel</u> Glen R. Wherfel	Director	March 14, 2014

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements No. 333-127737 and No. 333-137082 on Form S-8 of BankFinancial Corporation, of our report dated March 14, 2014, with respect to the consolidated financial statements of BankFinancial Corporation and the effectiveness of the Company's internal control over financial reporting, which report appears in this Annual Report on Form 10-K of BankFinancial Corporation for the year ended December 31, 2013.

/s/ Crowe Horwath LLP

Oak Brook, Illinois  
March 14, 2014

**Certification of Chief Executive Officer  
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, F. Morgan Gasior, certify that:

1. I have reviewed this Annual Report on Form 10-K of BankFinancial Corporation, a Maryland 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 the 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) 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;
  - d) 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 functions):
  - 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: March 14, 2014

/s/ F. Morgan Gasior

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

**Certification of Chief Financial Officer  
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Paul A. Cloutier, certify that:

1. I have reviewed this Annual Report on Form 10-K of BankFinancial Corporation, a Maryland 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 the 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) 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;
  - d) 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 functions):
  - 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: March 14, 2014

/s/ Paul A. Cloutier

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Paul A. Cloutier  
Executive Vice President and  
Chief Financial Officer

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

F. Morgan Gasior, Chairman of the Board, Chief Executive Officer and President of BankFinancial Corporation, a Maryland corporation (the "Company") and Paul A. Cloutier, Executive Vice President and Chief Financial Officer of the Company, each certify in his capacity as an officer of the Company that he has reviewed the annual report on Form 10-K for the year ended December 31, 2013 (the "Report") and that to the best of his knowledge:

1. the Report fully complies with the requirements of Sections 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.

Date: March 14, 2014

/s/ F. Morgan Gasior

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

Date: March 14, 2014

/s/ Paul A. Cloutier

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Paul A. Cloutier  
Executive Vice President and Chief Financial  
Officer

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