

BankFinancial CORP
Form 10-Q
October 26, 2018

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

FORM 10-Q

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

For the Quarterly Period ended September 30, 2018

or

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

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

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

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

15W060 North Frontage Road, Burr Ridge,
Illinois 60527

(Address of Principal Executive Offices)

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

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

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

Edgar Filing: BankFinancial CORP - Form 10-Q

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date. At October 24, 2018, there were 16,996,173 shares of Common Stock, \$0.01 par value, outstanding.

BANKFINANCIAL CORPORATION

Form 10-Q

September 30, 2018

Table of Contents

	Page Number
<u>PART I</u>	
Item 1. <u>Financial Statements</u>	<u>1</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>25</u>
Item 3. <u>Quantitative and Qualitative Disclosure about Market Risk</u>	<u>40</u>
Item 4. <u>Controls and Procedures</u>	<u>42</u>
<u>PART II</u>	
Item 1. <u>Legal Proceedings</u>	<u>43</u>
Item 1A. <u>Risk Factors</u>	<u>43</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>43</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>43</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>43</u>
Item 5. <u>Other Information</u>	<u>43</u>
Item 6. <u>Exhibits</u>	<u>43</u>
<u>Signatures</u>	<u>45</u>

Table of Contents

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

	September 30, 2018	December 31, 2017
Assets		
Cash and due from other financial institutions	\$ 12,473	\$ 13,572
Interest-bearing deposits in other financial institutions	74,461	114,020
Cash and cash equivalents	86,934	127,592
Securities, at fair value	103,921	93,383
Loans receivable, net of allowance for loan losses: September 30, 2018, \$8,103 and December 31, 2017, \$8,366	1,267,787	1,314,651
Other real estate owned, net	985	2,351
Stock in Federal Home Loan Bank ("FHLB") and Federal Reserve Bank ("FRB"), at cost	8,026	8,290
Premises held-for-sale	—	5,667
Premises and equipment, net	24,473	24,856
Accrued interest receivable	4,974	4,619
Core deposit intangible	123	286
Bank owned life insurance	18,781	22,859
Deferred taxes	8,911	12,563
Other assets	7,569	8,441
Total assets	\$ 1,532,484	\$ 1,625,558
Liabilities		
Deposits		
Noninterest-bearing	\$ 225,446	\$ 234,354
Interest-bearing	1,070,324	1,105,697
Total deposits	1,295,770	1,340,051
Borrowings	21,232	60,768
Advance payments by borrowers for taxes and insurance	11,015	11,645
Accrued interest payable and other liabilities	12,384	15,460
Total liabilities	1,340,401	1,427,924
Stockholders' equity		
Preferred Stock, \$0.01 par value, 25,000,000 shares authorized, none issued or outstanding	—	—
Common Stock, \$0.01 par value, 100,000,000 shares authorized; 17,206,303 shares issued at September 30, 2018 and 17,958,723 issued at December 31, 2017	172	179
Additional paid-in capital	141,230	153,811
Retained earnings	50,437	43,274
Accumulated other comprehensive income	244	370
Total stockholders' equity	192,083	197,634
Total liabilities and stockholders' equity	\$ 1,532,484	\$ 1,625,558

See accompanying notes to the consolidated financial statements.

Table of Contents

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Interest and dividend income				
Loans, including fees	\$14,248	\$13,345	\$42,045	\$39,061
Securities	627	389	1,637	1,095
Other	498	387	1,459	976
Total interest income	15,373	14,121	45,141	41,132
Interest expense				
Deposits	2,278	1,419	5,632	3,903
Borrowings	130	196	542	444
Total interest expense	2,408	1,615	6,174	4,347
Net interest income	12,965	12,506	38,967	36,785
Recovery of loan losses	(23)	(225)	(258)	(15)
Net interest income after recovery of loan losses	12,988	12,731	39,225	36,800
Noninterest income				
Deposit service charges and fees	1,003	1,018	2,970	2,964
Loan fee income	71	89	231	212
Commercial mortgage brokerage fees	12	—	138	—
Residential mortgage banking fees	34	41	88	172
Loss on sales of equity securities	—	—	(14)	—
Gain on sale of premises held-for-sale	—	—	93	—
Trust and insurance commissions and annuities income	207	210	670	704
Earnings on bank-owned life insurance	35	67	146	196
Bank-owned life insurance death benefit	—	—	1,389	—
Other	208	198	492	526
Total noninterest income	1,570	1,623	6,203	4,774
Noninterest expense				
Compensation and benefits	5,120	5,330	16,232	16,792
Office occupancy and equipment	1,629	1,693	5,022	4,914
Advertising and public relations	194	167	611	807
Information technology	717	638	2,066	2,070
Supplies, telephone, and postage	341	337	1,070	1,027
Amortization of intangibles	20	123	163	374
Nonperforming asset management	60	84	313	215
Operations of other real estate owned	59	403	355	861
FDIC insurance premiums	115	150	338	462
Other	1,170	1,275	3,429	3,551
Total noninterest expense	9,425	10,200	29,599	31,073
Income before income taxes	5,133	4,154	15,829	10,501
Income tax expense	1,396	594	3,903	2,488
Net income	\$3,737	\$3,560	\$11,926	\$8,013
Basic earnings per common share	\$0.22	\$0.20	\$0.68	\$0.44
Diluted earnings per common share	\$0.22	\$0.20	\$0.68	\$0.44
Weighted average common shares outstanding	17,365,679	18,139,659	17,641,308	18,368,742

Edgar Filing: BankFinancial CORP - Form 10-Q

Diluted weighted average common shares outstanding 17,365,679 18,140,109 17,641,308 18,369,170

See accompanying notes to the consolidated financial statements.

2

Table of Contents

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

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Net income	\$3,737	\$3,560	\$11,926	\$8,013
Unrealized holding gain (loss) arising during the period	(49)	16	(173)	(67)
Tax effect	13	(9)	47	22
Net of tax	(36)	7	(126)	(45)
Comprehensive income	\$3,701	\$3,567	\$11,800	\$7,968

See accompanying notes to the consolidated financial statements.

Table of Contents

BANKFINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except per share data) - Unaudited

	Common Stock	Additional Paid-in Capital	Retained Earnings	Unearned Employee Stock Ownership Plan Shares	Accumulated Other Comprehen- sive Income	Total
Balance at January 1, 2017	\$ 192	\$ 173,047	\$ 39,483	\$ (8,318)	\$ 376	\$ 204,780
Net income	—	—	8,013	—	—	8,013
Other comprehensive loss, net of tax	—	—	—	—	(45)	(45)
Net exercise of stock options (198,026 shares)	2	(1,239)	—	—	—	(1,237)
Prepayment of ESOP Share Acquisition Loan	(8)	(7,185)	—	8,318	—	1,125
Repurchase and retirement of common stock (614,673 shares)	(6)	(9,142)	—	—	—	(9,148)
Cash dividends declared on common stock (\$0.20 per share)	—	—	(3,710)	—	—	(3,710)
Balance at September 30, 2017	\$ 180	\$ 155,481	\$ 43,786	\$ —	\$ 331	\$ 199,778
Balance at January 1, 2018	\$ 179	\$ 153,811	\$ 43,274	\$ —	\$ 370	\$ 197,634
Net income	—	—	11,926	—	—	11,926
Other comprehensive loss, net of tax	—	—	—	—	(126)	(126)
Nonvested stock awards-stock-based compensation expense	—	6	—	—	—	6
Repurchase and retirement of common stock (752,174 shares)	(7)	(12,587)	—	—	—	(12,594)
Cash dividends declared on common stock (\$0.27 per share)	—	—	(4,763)	—	—	(4,763)
Balance at September 30, 2018	\$ 172	\$ 141,230	\$ 50,437	\$ —	\$ 244	\$ 192,083

See accompanying notes to the consolidated financial statements.

Table of Contents

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

	Nine Months Ended September 30, 2018 2017	
Cash flows from operating activities		
Net income	\$11,926	\$8,013
Adjustments to reconcile to net income to net cash from operating activities		
Recovery of loan losses	(258)	(15)
Prepayment of ESOP Share Acquisition Loan	—	1,125
Stock-based compensation expense	6	—
Depreciation and amortization	2,513	2,846
Amortization of premiums and discounts on securities and loans	9	(72)
Amortization of core deposit intangible	163	374
Amortization of servicing assets	79	86
Net change in net deferred loan origination costs	53	343
Loss on sale of other real estate owned	56	100
Net gain on sale of loans	—	(70)
Loss on sale of equity securities	14	—
Gain on sale of premises held-for-sale	(93)	—
Loans originated for sale	—	(1,291)
Proceeds from sale of loans	—	1,361
Other real estate owned valuation adjustments	27	301
Net change in:		
Accrued interest receivable	(355)	(188)
Earnings on bank owned life insurance	(146)	(196)
Other assets	3,540	4,027
Accrued interest payable and other liabilities	(3,076)	(1,966)
Net cash from operating activities	14,458	14,778
Cash flows from investing activities		
Securities		
Proceeds from maturities	76,164	49,695
Proceeds from principal repayments	2,970	2,461
Proceeds from sale of equity securities	487	—
Purchases of securities	(90,355)	(43,808)
Loans receivable		
Loan participations sold	—	3,615
Principal payments on loans receivable	729,474	459,706
Purchase of loans	—	(23,451)
Originated for investment	(683,685)	(465,562)
Purchase of FHLB and FRB stock	(21)	(154)
Redemption of FHLB and FRB stock	285	3,514
Bank-owned life insurance death benefit	4,224	—
Proceeds from sale of premises held-for-sale	5,485	—
Proceeds from sale of other real estate owned	2,172	1,966
Purchase of premises and equipment, net	(512)	(906)

Net cash from (used in) investing activities	46,688	(12,924)
--	--------	----------

Continued

5

Table of Contents

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

	Nine Months Ended September 30,	
	2018	2017
Cash flows from financing activities		
Net change in deposits	\$(44,281)	\$31,699
Net change in borrowings	(39,536)	9,859
Net change in advance payments by borrowers for taxes and insurance	(630)	(358)
Repurchase and retirement of common stock	(12,594)	(9,148)
Cash dividends paid on common stock	(4,763)	(3,710)
Shares retired for tax liability	—	(1,219)
Net cash from (used in) financing activities	(101,804)	27,123
Net change in cash and cash equivalents	(40,658)	28,977
Beginning cash and cash equivalents	127,592	96,684
Ending cash and cash equivalents	\$86,934	\$125,661
Supplemental disclosures of cash flow information:		
Interest paid	\$5,960	\$4,269
Income taxes paid	250	198
Loans transferred to other real estate owned	1,241	2,041

See accompanying notes to the consolidated financial statements.

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation: BankFinancial Corporation, a Maryland corporation headquartered in Burr Ridge, Illinois, is the owner of all of the issued and outstanding capital stock of BankFinancial, NA (the “Bank”). The interim unaudited consolidated financial statements include the accounts and transactions of BankFinancial Corporation, the Bank, and the Bank’s wholly-owned subsidiaries, Financial Assurance Services, Inc. and BFIN Asset Recovery Company, LLC (collectively, “the Company”), and reflect all normal and recurring adjustments that are, in the opinion of management, considered necessary for a fair presentation of the financial condition and results of operations for the periods presented. Such adjustments are the only adjustments reflected in the accompanying financial statements. All significant intercompany accounts and transactions have been eliminated. The results of operations for the three and nine month periods ended September 30, 2018 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2018 or for any other period.

Certain information and note disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

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

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

These unaudited consolidated financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the Securities and Exchange Commission.

Recent Accounting Pronouncements

In May 2014, the FASB issued an update (ASU No. 2014-09, Revenue from Contracts with Customers) creating FASB Topic 606, Revenue from Contracts with Customers. The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The amendments in this update became effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. We have evaluated the impact of adopting the update and have concluded that it does not have a significant impact to our consolidated financial statements. The Company’s revenue streams that are in-scope from the update include: financed OREO sales; deposit fees, including ATM fees, overdraft fees, maintenance fees and dormancy fees; debit card fees, and trust fees. For the in-scope revenue streams, our current revenue recognition is not different than our prior revenue recognition under the update. The Company has infrequently financed an OREO sale. Our customer contracts generally do not have performance obligations and fees are assessed and collected as the transaction occurs. The Company’s fee income is not material for any individual income streams. The adoption of ASC 606 did not result in a change to the accounting for any of the in-scope revenue stream; as such, no cumulative effect adjustment was recorded. Refer to Note 8 - Revenue for Contracts with Customers for further discussion on the Company’s accounting policies for revenue sources within the scope of ASC 606.

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

Table of Contents

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)

cost on the balance sheet; and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in fair value of a liability resulting from the change in the instrument-specific credit risk (also referred to as “own credit”) when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. The new guidance became effective for public business entities for fiscal years beginning after December 15, 2017. The new pronouncement does not have a significant impact on our Statement of Operations, as we had one equity security that was valued at \$499,000 at December 31, 2017 and none at September 30, 2018.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”). The standard requires a lessee to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 months. ASU 2016-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, and early adoption is permitted. We are currently evaluating the impact that the standard will have on our consolidated financial statements. Our preliminary finding is that the new pronouncement will not have a significant impact on our consolidated financial statements as the projected minimum lease payments under existing leases subject to the new pronouncement are less than one percent of our current total assets.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”). These amendments require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses.

In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019 (i.e., January 1, 2020, for calendar year entities). Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. We are currently evaluating the impact that the standard will have on our consolidated financial statements. Our initial review indicates that we have maintained sufficient historical loan data to support the requirements of this pronouncement. In addition, we have begun tracking the average life of the various segments of our loan portfolio. We are currently evaluating various loss methodologies to determine their correlation to our various loan categories' historical performance. In August 2018, we contracted with a third-party vendor to provide a model and assist with assessing processes, portfolio segmentation, and model development.

In March 2017, the FASB issued ASU No. 2017-08, “Receivables-Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities” (“ASU 2017-08”). This guidance shortens the amortization period for premiums on certain callable debt securities to the earliest call date (with an explicit, noncontingent call feature that is callable at a fixed price and on a preset dates), rather than contractual maturity date as currently required under GAAP. The ASU does not impact instruments without preset call dates such as mortgage-backed securities. For instruments with contingent call features, once the contingency is resolved and the security is callable at a fixed price and preset date, the security is within the scope of the ASU. ASU 2017-08 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, and early adoption is permitted. Effective January 2017, we early adopted the pronouncement. Adoption of the new pronouncement was immaterial to the consolidated financial statements.

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 2 - EARNINGS PER SHARE

Amounts reported in earnings per share reflect earnings available to common stockholders for the period divided by the weighted average number of shares of common stock outstanding during the period, exclusive of unearned BankFinancial, NA Employee Stock Ownership Plan (the "ESOP") shares in 2017 and unvested restricted stock shares. Stock options and restricted stock are regarded as potential common stock and are considered in the diluted earnings per share calculations to the extent that they would have a dilutive effect if converted to common stock.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net income available to common stockholders	\$3,737	\$ 3,560	\$11,926	\$ 8,013
Average common shares outstanding	17,365,678	14,059,599	17,641,743	18,567,796
Less:				
Unearned ESOP shares	—	—	—	(198,114)
Unvested restricted stock shares	—	(940)	(435)	(940)
Weighted average common shares outstanding	17,365,678	13,969,659	17,641,308	18,368,742
Add - Net effect of dilutive unvested restricted stock	—	450	—	428
Diluted weighted average common shares outstanding	17,365,678	14,010,109	17,641,308	18,369,170
Basic earnings per common share	\$0.22	\$ 0.20	\$0.68	\$ 0.44
Diluted earnings per common share	\$0.22	\$ 0.20	\$0.68	\$ 0.44

NOTE 3 - SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2018				
Certificates of deposit	\$ 89,175	\$ —	\$ —	\$ 89,175
Mortgage-backed securities - residential	10,593	393	(61)	10,925
Collateralized mortgage obligations - residential	3,819	13	(11)	3,821
	\$ 103,587	\$ 406	\$ (72)	\$ 103,921
December 31, 2017				
Certificates of deposit	\$ 75,916	\$ —	\$ —	\$ 75,916
Equity mutual fund	500	—	(1)	499
Mortgage-backed securities - residential	11,969	520	(17)	12,472
Collateralized mortgage obligations - residential	4,481	16	(11)	4,486
SBA-guaranteed loan participation certificates	10	—	—	10
	\$ 92,876	\$ 536	\$ (29)	\$ 93,383

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 3 - SECURITIES (continued)

The mortgage-backed securities and collateralized mortgage obligations reflected in the preceding table were issued by U.S. government-sponsored entities or agencies, Freddie Mac, Fannie Mae and Ginnie Mae, and are obligations which the government has affirmed its commitment to support. All securities reflected in the preceding table were classified as available-for-sale at September 30, 2018 and December 31, 2017.

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

	September 30, 2018	
	Amortized Cost	Fair Value
Due in one year or less	\$89,175	\$89,175
Mortgage-backed securities - residential	10,593	10,925
Collateralized mortgage obligations - residential	3,819	3,821
	\$103,587	\$103,921

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Proceeds	\$ —	\$ —	\$ 487	\$ —
Gross gains	—	—	—	—
Gross losses	—	—	(14)	—

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

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
September 30, 2018						
Mortgage-backed securities - residential	\$924	\$ (6)	\$1,004	\$ (55)	\$1,928	\$ (61)
Collateralized mortgage obligations - residential	—	—	1,796	(11)	1,796	(11)
	\$924	\$ (6)	\$2,800	\$ (66)	\$3,724	\$ (72)
December 31, 2017						
Equity mutual fund	\$499	\$ (1)	\$—	\$ —	\$499	\$ (1)
Mortgage-backed securities - residential	—	—	1,149	(17)	1,149	(17)
Collateralized mortgage obligations - residential	—	—	2,083	(11)	2,083	(11)
	\$499	\$ (1)	\$3,232	\$ (28)	\$3,731	\$ (29)

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.

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 3 - SECURITIES (continued)

Certain mortgage-backed securities and collateralized mortgage obligations that the Company holds in its investment portfolio were in an unrealized loss position at September 30, 2018, but the unrealized losses were not considered significant under the Company's impairment testing methodology. In addition, the Company does not intend to sell these securities, and it is likely that the Company will not be required to sell these securities before their anticipated recovery occurs.

NOTE 4 - LOAN RECEIVABLE

Loans receivable are as follows:

	September 30, 2018	December 31, 2017
One-to-four family residential real estate	\$ 77,591	\$ 97,814
Multi-family mortgage	581,880	588,383
Nonresidential real estate	148,010	169,971
Construction and land	1,130	1,358
Commercial loans	167,547	152,552
Commercial leases	297,103	310,076
Consumer	1,416	1,597
	1,274,677	1,321,751
Net deferred loan origination costs	1,213	1,266
Allowance for loan losses	(8,103)	(8,366)
Loans, net	\$ 1,267,787	\$ 1,314,651

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

	Allowance for loan losses		Loan Balances		
	Individually evaluated for impairment	Collectively evaluated for impairment	Individually evaluated for impairment	Collectively evaluated for impairment	Total
September 30, 2018					
One-to-four family residential real estate	\$— 762	\$762	\$2,724	\$74,867	\$77,591
Multi-family mortgage	—3,722	3,722	661	581,219	581,880
Nonresidential real estate	—1,410	1,410	—	148,010	148,010
Construction and land	—27	27	—	1,130	1,130
Commercial loans	—1,482	1,482	—	167,547	167,547
Commercial leases	—684	684	—	297,103	297,103
Consumer	—16	16	—	1,416	1,416
	\$— 8,103	\$8,103	\$3,385	\$1,271,292	1,274,677
Net deferred loan origination costs					1,213
Allowance for loan losses					(8,103)
Loans, net					\$1,267,787

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

	Allowance for loan losses		Loan Balances		
	Individually evaluated for impairment	Collectively evaluated for impairment	Individually evaluated for impairment	Collectively evaluated for impairment	Total
December 31, 2017					
One-to-four family residential real estate	\$—	\$ 850	\$ 4,265	\$ 93,549	\$ 97,814
Multi-family mortgage	—	3,849	949	587,434	588,383
Nonresidential real estate	—	1,605	—	169,971	169,971
Construction and land	—	32	—	1,358	1,358
Commercial loans	—	1,357	—	152,552	152,552
Commercial leases	—	655	—	310,076	310,076
Consumer	—	18	—	1,597	1,597
	\$—	\$ 8,366	\$ 5,214	\$ 1,316,537	\$ 1,321,751
Net deferred loan origination costs					1,266
Allowance for loan losses					(8,366)
Loans, net					\$ 1,314,651

Activity in the allowance for loan losses is as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Beginning balance	\$8,179	\$8,122	\$8,366	\$8,127
Loans charged off:				
One-to-four family residential real estate	(84)	(89)	(214)	(282)
Multi-family mortgage	—	(7)	(35)	(10)
Nonresidential real estate	—	—	—	(165)
Commercial loans	—	—	(140)	—
Consumer	(6)	(7)	(7)	(7)
	(90)	(103)	(396)	(464)
Recoveries:				
One-to-four family residential real estate	25	15	130	100
Multi-family mortgage	8	11	26	62
Nonresidential real estate	—	10	—	10
Construction and land	2	—	2	—
Commercial loans	2	542	227	552
Commercial leases	—	2	5	2
Consumer	—	—	1	—
	37	580	391	726
Net recoveries (charge-offs)	(53)	477	(5)	262
Recovery of loan losses	(23)	(225)	(258)	(15)
Ending balance	\$8,103	\$8,374	\$8,103	\$8,374

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

Impaired loans

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

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

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

					Three months ended September 30, 2018	Interest Income Recognized	Nine months ended September 30, 2018	Interest Income Recognized
	Loan Balance	Recorded Investment	Partial Charge-off	Allowance for Loan Losses Allocated	Average Investment in Impaired Loans	Interest Income Recognized	Average Investment in Impaired Loans	Interest Income Recognized
September 30, 2018								
With no related allowance recorded:								
One-to-four family residential real estate	\$ 3,322	\$ 2,677	\$ 656	\$	—\$3,154	\$ 13	\$3,584	\$ 35
One-to-four family residential real estate - non-owner occupied	86	46	43	—	46	—	110	—
Multi-family mortgage - Illinois	661	665	—	—	666	10	836	30
	\$ 4,069	\$ 3,388	\$ 699	\$	—\$3,866	\$ 23	\$ 4,530	\$ 65
Year ended December 31, 2017								
	Loan Balance	Recorded Investment	Partial Charge-off	Allowance for Loan Losses Allocated	Average Investment in Impaired Loans	Interest Income Recognized	Average Investment in Impaired Loans	Interest Income Recognized
December 31, 2017								
With no related allowance recorded:								
One-to-four family residential real estate	\$ 5,049	\$ 4,248	\$ 806	\$	—\$4,212	\$ 197		
Multi-family mortgage - Illinois	958	948	—	—	847	41		

Edgar Filing: BankFinancial CORP - Form 10-Q

\$ 6,007 \$ 5,196 \$ 806 \$ —\$5,059 \$ 238

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

Nonaccrual Loans

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

	Loan	Recorded	Loans Past
	Balance	Investment	Due Over 90
			Days, Still
			Accruing
September 30, 2018			
One-to-four family residential real estate	\$ 1,646	\$ 1,313	\$ —
One-to-four family residential real estate – non-owner occupied	95	56	—
Multi-family mortgage - Illinois	102	102	—
	\$ 1,843	\$ 1,471	\$ —
December 31, 2017			
One-to-four family residential real estate	\$ 3,413	\$ 1,918	\$ —
One-to-four family residential real estate – non-owner occupied	308	109	—
Multi-family mortgage - Illinois	376	363	—
	\$ 4,097	\$ 2,390	\$ —

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

The Company's reserve for uncollected loan interest was \$36,000 and \$103,000 at September 30, 2018 and December 31, 2017, respectively. When a loan is on nonaccrual status and the ultimate collectability of the total principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. Alternatively, when a loan is on non-accrual status but there is doubt concerning only the ultimate collectability of interest, contractual interest is credited to interest income only when received, under the cash basis method pursuant to the provisions of FASB ASC 310-10, as applicable. In all cases, the average balances are calculated based on the month-end balances of the financing receivables within the period reported pursuant to the provisions of FASB ASC 310-10, as applicable.

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

Past Due Loans

The following tables present the aging of the recorded investment of loans at September 30, 2018 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Loans Due	Loans Not Past Due	Total
One-to-four family residential real estate loans	\$ 392	\$ —	\$ 1,329	\$ 1,721	\$ 59,925	\$ 61,646
One-to-four family residential real estate loans – non-owner occupied	34	8	48	90	15,817	15,907
Multi-family mortgage - Illinois	—	—	102	102	275,714	275,816
Multi-family mortgage - Other	—	—	—	—	299,469	299,469
Nonresidential real estate	607	—	—	607	146,394	147,001
Construction	—	—	—	—	932	932
Land	—	—	—	—	198	198
Commercial loans:						
Regional commercial banking	—	—	—	—	50,105	50,105
Health care	—	—	—	—	69,248	69,248
Direct commercial lessor	—	—	—	—	48,942	48,942
Commercial leases:						
Investment rated commercial leases	787	—	—	787	181,402	182,189
Other commercial leases	—	—	—	—	116,651	116,651
Consumer	12	5	—	17	1,410	1,427
	\$ 1,832	\$ 13	\$ 1,479	\$ 3,324	\$ 1,266,207	\$ 1,269,531

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

The following tables present the aging of the recorded investment of loans at December 31, 2017 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
One-to-four family residential real estate loans	\$ 86	\$ 99	\$ 1,801	\$ 1,986	\$ 74,216	\$ 76,202
One-to-four family residential real estate loans – non-owner occupied	10	3	86	99	20,944	21,043
Multi-family mortgage - Illinois	172	—	364	536	287,171	287,707
Multi-family mortgage - Other	—	—	—	—	296,440	296,440
Nonresidential real estate	608	—	—	608	166,071	166,679
Construction	—	—	—	—	1,103	1,103
Land	—	—	—	—	259	259
Commercial loans:						
Regional commercial banking	—	—	—	—	40,935	40,935
Health care	—	—	—	—	71,738	71,738
Direct commercial lessor	—	—	—	—	40,237	40,237
Commercial leases:						
Investment rated commercial leases	934	—	—	934	207,747	208,681
Other commercial leases	288	—	—	288	102,873	103,161
Consumer	—	—	—	—	1,605	1,605
	\$ 2,098	\$ 102	\$ 2,251	\$ 4,451	\$ 1,311,339	\$ 1,315,790

Troubled Debt Restructurings

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

The Company had \$17,000 of TDRs at September 30, 2018 and December 31, 2017. No specific valuation reserves were allocated to those loans at September 30, 2018 and December 31, 2017. The Company had no outstanding commitments to borrowers whose loans were classified as TDRs at either date.

The following table presents loans classified as TDRs:

	September 30, 2018	December 31, 2017
One-to-four family residential real estate - nonaccrual	\$ 17	\$ 17

During the three and nine months ended September 30, 2018 and 2017, there were no loans modified and classified as TDRs.

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

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

	2018	2017
	Number of Recorded investment loans	Number of Recorded investment loans
One-to-four family residential real estate	—	—
	\$	\$ 17

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

There were no payment defaults on TDRs within twelve months following the modification during the three and nine months ended September 30, 2018.

There were no loan modifications during the three and nine months ended September 30, 2018. There were certain loan modifications during the three and nine months ended September 30, 2017 that did not meet the definition of a TDR. These loans had a total recorded investment of \$149,000 at September 30, 2017. 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.

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.

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

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

As of September 30, 2018, based on the most recent analysis performed, the risk categories of loans by class of loans are as follows:

	Pass	Special Mention	Substandard	Nonaccrual	Total
One-to-four family residential real estate loans	\$59,714	\$ 310	\$ 372	\$ 1,314	\$61,710
One-to-four family residential real estate loans – non-owner occupied	15,755	33	37	56	15,881
Multi-family mortgage loans - Illinois	276,398	—	310	102	276,810
Multi-family mortgage loans - Other	305,070	—	—	—	305,070
Nonresidential real estate loans	147,911	—	99	—	148,010
Construction loans	929	—	—	—	929
Land loans	201	—	—	—	201
Commercial loans:					
Regional commercial banking	45,170	4,815	—	—	49,985
Health care	64,374	—	4,699	—	69,073
Direct commercial lessor	48,489	—	—	—	48,489
Commercial leases:					
Investment rated commercial leases	180,383	748	—	—	181,131
Other commercial leases	115,972	—	—	—	115,972
Consumer	1,401	5	10	—	1,416
	\$1,261,767	\$ 5,911	\$ 5,527	\$ 1,472	\$1,274,677

As of December 31, 2017, the risk categories of loans by class of loans are as follows:

	Pass	Special Mention	Substandard	Nonaccrual	Total
One-to-four family residential real estate loans	\$74,437	\$—	\$ 255	\$ 1,914	\$76,606
One-to-four family residential real estate loans – non-owner occupied	21,059	—	40	109	21,208
Multi-family mortgage loans - Illinois	290,765	—	225	368	291,358
Multi-family mortgage loans - Other	297,025	—	—	—	297,025
Nonresidential real estate loans	169,817	—	154	—	169,971
Construction loans	1,099	—	—	—	1,099
Land loans	259	—	—	—	259
Commercial loans:					
Regional commercial banking	36,373	4,528	—	—	40,901
Health care	69,480	—	2,248	—	71,728
Direct commercial lessor	39,923	—	—	—	39,923
Commercial leases:					
Investment rated commercial leases	207,460	—	—	—	207,460
Other commercial leases	102,616	—	—	—	102,616
Consumer	1,597	—	—	—	1,597
	\$1,311,910	\$ 4,528	\$ 2,922	\$ 2,391	\$1,321,751

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5 - OTHER REAL ESTATE OWNED

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

	September 30, 2018			December 31, 2017		
	Balance	Valuation Allowance	Net OREO Balance	Balance	Valuation Allowance	Net OREO Balance
One-to-four family residential	\$634	\$ —	\$ 634	\$836	\$ (9)	\$ 827
Multi-family mortgage	276	—	276	—	—	—
Nonresidential real estate	74	—	74	1,772	(252)	1,520
Land	24	(23)	1	48	(44)	4
	\$1,008	\$ (23)	\$ 985	\$2,656	\$ (305)	\$ 2,351

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

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Beginning balance	\$1,187	\$4,896	\$2,351	\$3,895
New foreclosed properties	403	105	1,241	2,041
Valuation adjustments	(1)	(227)	(27)	(301)
Sales and payments	(604)	(1,205)	(2,580)	(2,066)
Ending balance	\$985	\$3,569	\$985	\$3,569

Activity in the valuation allowance is as follows:

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Beginning balance	\$44	\$308	\$305	\$449
Additions charged to expense	1	227	27	301
Reductions from sales of OREO	(22)	(63)	(309)	(278)
Ending balance	\$23	\$472	\$23	\$472

At September 30, 2018, the balance of OREO included no foreclosed residential real estate properties recorded as a result of obtaining physical possession of the property without title. At December 31, 2017 the balance of OREO included \$352,000 of foreclosed residential real estate properties recorded as a result of obtaining physical possession of the property without title. At September 30, 2018 and December 31, 2017, the recorded investment of consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process was \$603,000 and \$1.5 million, respectively.

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

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

	Overnight and Continuous	Up to 30 days	30 - 90 days	Greater Than 90 days	Total
September 30, 2018					
Repurchase agreements and repurchase-to-maturity transactions	\$ 1,232	\$ —	\$ —		—\$1,232
Gross amount of recognized liabilities for repurchase agreements in Statement of Condition					\$1,232
December 31, 2017					
Repurchase agreements and repurchase-to-maturity transactions	\$ 768	\$ —	\$ —		—\$768
Gross amount of recognized liabilities for repurchase agreements in Statement of Condition					\$768

Securities sold under agreements to repurchase were secured by mortgage-backed securities with a carrying amount of \$2.7 million and \$3.7 million at September 30, 2018 and December 31, 2017, respectively. Also included in total borrowings were advances from the FHLB of \$20.0 million at September 30, 2018 and \$60.0 million at December 31, 2017.

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

NOTE 7 – FAIR VALUE

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

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

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

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

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

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

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal

process by the independent appraisers to adjust for differences between the comparable sales and income data available for similar loans and collateral underlying such loans. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted in accordance with the allowance policy.

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7 - FAIR VALUE (continued)

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

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

	Fair Value Measurements Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)			Fair Value
	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)		
September 30, 2018				
Securities:				
Certificates of deposit	\$—	\$ 89,175	\$	—\$89,175
Mortgage-backed securities – residential	—	10,925	—	10,925
Collateralized mortgage obligations – residential	—	3,821	—	3,821
	\$—	\$ 103,921	\$	—\$103,921
December 31, 2017				
Securities:				
Certificates of deposit	\$—	\$ 75,916	\$	—\$75,916
Equity mutual fund	499	—	—	499
Mortgage-backed securities - residential	—	12,472	—	12,472
Collateralized mortgage obligations – residential	—	4,486	—	4,486
SBA-guaranteed loan participation certificates	—	10	—	10
	\$499	\$ 92,884	\$	—\$93,383

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7 - FAIR VALUE (continued)

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

	Fair Value Measurement			
	Using			
	Quoted			
	Prices in			
	Active	Significant	Significant	Fair
	Markets	Observable	Unobservable	Value
	for	Inputs	Inputs	
	Identical	(Level 2)	(Level 3)	
	Assets			
	(Level			
	1)			
September 30, 2018				
Other real estate owned:				
Land	\$ —	—\$	1	\$ 1
December 31, 2017				
Other real estate owned:				
One-to-four family residential real estate	\$ —	—\$	102	\$ 102
Nonresidential real estate	—	—	814	814
	\$ —	—\$	916	\$ 916

At September 30, 2018 and December 31, 2017 there were no impaired loans that were measured for impairment using the fair value of the collateral for collateral-dependent loans and which had specific valuation allowances. OREO, which is carried at the lower of cost or fair value less costs to sell, and had a carrying value of \$24,000 less a valuation allowance of \$23,000, or \$1,000 at September 30, 2018, compared to a carrying value of \$1.2 million less a valuation allowance of \$261,000, or \$916,000, at December 31, 2017. There were \$27,000 and \$301,000 of valuation adjustments of OREO recorded for the nine months ended September 30, 2018 and 2017, respectively.

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:

	Fair Value	Valuation Technique(s)	Significant Unobservable Input(s)	Range (Weighted Average)
September 30, 2018				
Other real estate owned:				
Land	1	Sales comparison	Discount applied to valuation	12.3%
	\$ 1			
December 31, 2017				
Other real estate owned				
One-to-four family residential real estate	\$ 102	Sales comparison	Discount applied to valuation	5.6%
Nonresidential real estate	814	Sales comparison	Comparison between sales and income approaches	-3.66% to 15.22%

\$ 916

22

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7 - FAIR VALUE (continued)

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

	Carrying Amount	Fair Value Measurements at September 30, 2018 Using:			
		Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	\$ 86,934	\$ 12,473	\$ 74,461	\$ —	\$ 86,934
Securities	103,921	—	103,921	—	103,921
Loans receivable, net of allowance for loan losses	1,267,787	—	—	1,265,906	1,265,906
FHLB and FRB stock	8,026	—	—	—	N/A
Accrued interest receivable	4,974	—	4,974	—	4,974
Financial liabilities					
Noninterest-bearing demand deposits	\$ 225,446	\$ —	\$ 225,446	\$ —	\$ 225,446
NOW and money market accounts	549,631	—	549,631	—	549,631
Savings deposits	155,232	—	155,232	—	155,232
Certificates of deposit	365,461	—	362,670	—	362,670
Borrowings	21,232	—	21,214	—	21,214
Accrued interest payable	361	—	361	—	361
	Carrying Amount	Fair Value Measurements at December 31, 2017 Using:			
		Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	\$ 127,592	\$ 13,572	\$ 114,020	\$ —	\$ 127,592
Securities	93,383	499	92,884	—	93,383
Loans receivable, net of allowance for loan losses	1,314,651	—	1,323,139	—	1,323,139
FHLB and FRB stock	8,290	—	—	—	N/A
Accrued interest receivable	4,619	—	4,619	—	4,619
Financial liabilities					
Noninterest-bearing demand deposits	\$ 234,354	\$ —	\$ 234,354	\$ —	\$ 234,354
NOW and money market accounts	589,238	—	589,238	—	589,238
Savings deposits	160,501	—	160,501	—	160,501
Certificates of deposit	355,958	—	353,969	—	353,969
Borrowings	60,768	—	60,627	—	60,627
Accrued interest payable	147	—	147	—	147

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

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

Loans: At September 30, 2018, the exit price observations are obtained from an independent third-party using its proprietary valuation model and methodology and may not reflect actual or prospective market valuations. The valuation is based on the probability of default, loss given default, recovery delay, prepayment, and discount rate assumptions. The new methodology is a result of the adoption of ASU 2016-01.

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 7 - FAIR VALUE (continued)

At December 31, 2017, 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 methods utilized to estimate fair value of loans do not necessarily represent an exit price.

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

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

Borrowings: The estimated fair values of advances from the FHLB 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 8 – REVENUE FROM CONTRACTS WITH CUSTOMERS

All of the Company's revenue from contracts with customers in the scope of ASC 606 is recognized within noninterest income. The following table presents the Company's sources of noninterest income. Items outside of the scope of the ASC 606 are noted as such.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Deposit service charges and fees	\$1,003	\$1,018	\$2,970	\$2,964
Loan fee income ⁽¹⁾	71	89	231	212
Commercial mortgage brokerage fees ⁽¹⁾	12	—	138	—
Residential mortgage banking fees ⁽¹⁾	34	41	88	172
Loss on sales of equity securities ⁽¹⁾	—	—	(14) —
Gain on sale of premises held-for-sale	—	—	93	—
Trust and insurance commissions and annuities income	207	210	670	704
Earnings on bank owned life insurance ⁽¹⁾	35	67	146	196
Bank-owned life insurance death benefit ⁽¹⁾	—	—	1,389	—
Other ⁽¹⁾	208	198	492	526
Total noninterest income	\$1,570	\$1,623	\$6,203	\$4,774

(1) Not within the scope of ASC 606

24

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 8 – REVENUE FROM CONTRACTS WITH CUSTOMERS (continued)

A description of the Company's revenue streams accounted for under ASC 606 follows:

Deposit service charges and fees: The Company earns fees from its deposit customers based on specific types of transactions, account maintenance and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

Interchange income: The Company earns interchange fees from debit cardholder transactions conducted through the Visa payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder. Interchange income for the nine months ended September 30, 2018 and 2017 was \$1.1 million and \$1.1 million, respectively. Interchange income for the three months ended September 30, 2018 and 2017 was \$382,000 and \$361,000, respectively. Interchange income is included in deposit service charges and fees.

Gain on sale of premises held-for-sale: On April 23, 2018, the Bank sold its office building located at 15W060 North Frontage Road, Burr Ridge, Illinois. The sale was to an unrelated party and title was transferred at closing. As such, the transaction constituted a sale and a net gain was recorded in the second quarter of 2018.

Trust and insurance commissions and annuities income: The Company earns trust, insurance commissions and annuities income from its contracts with trust customers to manage assets for investment, and/or to transact on their accounts. These fees are primarily earned over time as the Company provides the contracted monthly or quarterly services and are generally assessed based on a tiered scale of the market value of assets under management (AUM) at month-end. Fees that are transaction based, including trade execution services, are recognized at the point in time that the transaction is executed, i.e., the trade date. Other related services provided include fees the Company earns, which are based on a fixed fee schedule, are recognized when the services are rendered.

Gains/losses on sales of OREO: The Company records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of OREO to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Company adjusts the transaction price and related gain (loss) on sale if a significant financing component is present. OREO sales for the nine months ended September 30, 2018 and September 30, 2017 were not financed by the Bank.

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

Cautionary Statement Regarding Forward-Looking Information

Forward Looking Statements

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

looking statements speak only as of the date made. They are frequently based on assumptions that may or may not materialize, and are subject to numerous uncertainties that could cause actual results to differ materially from those anticipated in the forward looking statements. We intend all forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and are including this statement for the purpose of invoking these safe harbor provisions.

Factors that could cause actual results to differ materially from the anticipated or projected results 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

Table of Contents

loan growth due to intense competition for high quality loans and leases, particularly in terms of pricing and credit underwriting, or a dearth of borrowers who meet our underwriting standards; (ii) the impact of re-pricing and competitors' pricing initiatives on loan and deposit products; (iii) interest rate movements and their impact on the economy, customer behavior and our net interest margin; (iv) adverse economic conditions in general, in the Chicago metropolitan area in particular and in other market areas where we operate that could result in increased delinquencies in our loan portfolio or a decline in the value of our investment securities and the collateral for our loans; (v) declines in real estate values that adversely impact the value of our loan collateral, OREO, asset dispositions and the level of borrower equity in their investments; (vi) borrowers that experience legal or financial difficulties that we do not currently foresee; (vii) results of supervisory monitoring or examinations by regulatory authorities, including the possibility that a regulatory authority could, among other things, require us to increase our allowance for loan losses or adversely change our loan classifications, write-down assets, reduce credit concentrations or maintain specific capital levels; (viii) changes, 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, 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 or tax principles, policies or guidelines; and (xvi) privacy and cybersecurity risks, including the risks of business interruption and the compromise of confidential customer information resulting from intrusions.

These risks and uncertainties, together with the Risk Factors and other information set forth in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as well as other filings we make with the SEC, should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. We do not undertake any obligation to update any forward-looking statement in the future, or to reflect circumstances and events that occur after the date on which the forward-looking statement was made.

Critical Accounting Policies

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that the most critical accounting policies upon which our financial condition and results of operation depend, and which involve the most complex subjective decisions or assessments, are included in the discussion entitled "Critical Accounting Policies" in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as filed with the SEC.

Overview

Total loans declined as strong originations in commercial lending and multifamily mortgage loans were offset by continued elevated payoffs for multifamily mortgage loans, commercial real estate loans and residential loans. Commercial and industrial loans increased by \$3.6 million (2.2%) and multifamily mortgage loans increased by \$10.0 million (1.7%) compared to June 30, 2018. Commercial leases decreased by \$19.5 million (6.1%), primarily due to the scheduled amortization of lower-yielding investment-grade leases in excess of investment-grade lease originations. Residential and commercial real estate loan balances declined due to portfolio amortization and prepayments. The Company's asset quality remained favorable. The ratio of nonperforming loans to total loans was 0.12% and the ratio of non-performing assets to total assets was 0.16% at September 30, 2018. Non-performing commercial-related loans represented 0.01% of total commercial-related loans. We expect continued reductions of the OREO balance and scheduled pending resolutions may improve certain asset quality ratios.

Retail and commercial core transaction deposit accounts were stable with some seasonal fluctuations. Retail certificate of deposit accounts increased by \$23.2 million (9.2%) to provide greater interest rate risk protection compared to retail money market deposit accounts given current and anticipated market conditions. Money market deposit accounts

declined by \$15.4 million (5.5%) primarily due to our interest rate risk management practices and moderate competitive posture. Total wholesale deposits and borrowings declined by \$31.7 million (3.40%) during the third quarter of 2018. The Company's liquid assets exceeded 12% of total assets at September 30, 2018.

The average yield on our loan and lease portfolio at September 30, 2018 was 4.43%, compared to an average loan and lease portfolio yield of 4.34% at June 30, 2018. The average yield on our securities portfolio was 2.20% at September 30, 2018, compared to an average yield of 2.04% at June 30, 2018. The total average cost of funds was 0.72%, compared to the average cost of funds

Table of Contents

of 0.61% at June 30, 2018. Our net interest margin expanded to 3.51% at September 30, 2018, compared to 3.49% at June 30, 2018.

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

Total noninterest expense decreased in the third quarter due to a second quarter payment of \$177,000 in special 401(k) contributions and an incentive accrual of \$298,000 for loan origination and business plan performance. Other noninterest income expense decreased modestly.

SELECTED FINANCIAL DATA

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

	September 30		Change			
	2018	2017				
(In thousands)						
Selected Financial Condition Data:						
Total assets	\$ 1,532,484	\$ 1,625,558	\$(93,074)			
Loans, net	1,267,787	1,314,651	(46,864)			
Securities, at fair value	103,921	93,383	10,538			
Other real estate owned, net	985	2,351	(1,366)			
Deposits	1,295,770	1,340,051	(44,281)			
Borrowings	21,232	60,768	(39,536)			
Equity	192,083	197,634	(5,551)			
	Three Months Ended			Nine Months Ended		
	September 30,		Change	September 30,		Change
	2018	2017		2018	2017	
(In thousands)						
Selected Operating Data:						
Interest income	\$ 15,373	\$ 14,121	\$ 1,252	\$ 45,141	\$ 41,132	\$ 4,009
Interest expense	2,408	1,615	793	6,174	4,347	1,827
Net interest income	12,965	12,506	459	38,967	36,785	2,182
Recovery of loan losses	(23)	(225)	202	(258)	(15)	(243)
Net interest income after recovery of loan losses	12,988	12,731	257	39,225	36,800	2,425
Noninterest income	1,570	1,623	(53)	6,203	4,774	1,429
Noninterest expense	9,425	10,200	(775)	29,599	31,073	(1,474)
Income before income tax expense	5,133	4,154	979	15,829	10,501	5,328
Income tax expense	1,396	594	802	3,903	2,488	1,415
Net income	\$ 3,737	\$ 3,560	\$ 177	\$ 11,926	\$ 8,013	\$ 3,913

Table of Contents

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Selected Financial Ratios and Other Data:				
Performance Ratios:				
Return on assets (ratio of net income to average total assets) ⁽¹⁾	0.97 %	0.88 %	1.02 %	0.66 %
Return on equity (ratio of net income to average equity) ⁽¹⁾	7.68	7.07	8.06	5.26
Average equity to average assets	12.64	12.40	12.62	12.61
Net interest rate spread ⁽¹⁾⁽²⁾	3.30	3.10	3.32	3.12
Net interest margin ⁽¹⁾⁽³⁾	3.51	3.23	3.51	3.24
Efficiency ratio ⁽⁴⁾	64.84	72.19	65.53	74.77
Noninterest expense to average total assets ⁽¹⁾	2.45	2.51	2.53	2.57
Average interest-earning assets to average interest-bearing liabilities	133.23	131.23	133.12	131.69
Dividends declared per share	\$0.10	\$0.07	\$0.27	\$0.20
Dividend payout ratio	46.65 %	35.69 %	39.94 %	46.30 %
	At September 30, 2018	At December 31, 2017		
Asset Quality Ratios:				
Nonperforming assets to total assets ⁽⁵⁾	0.16 %	0.29 %		
Nonperforming loans to total loans	0.12	0.18		
Allowance for loan losses to nonperforming loans	550.85	350.04		
Allowance for loan losses to total loans	0.64	0.63		
Capital Ratios:				
Equity to total assets at end of period	12.53 %	12.16 %		
Tier 1 leverage ratio (Bank only)	11.49 %	11.08 %		
Other Data:				
Number of full-service offices	19	19		
Employees (full-time equivalents)	245	236		

(1) Ratios annualized.

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

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

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

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

Comparison of Financial Condition at September 30, 2018 and December 31, 2017

Total assets decreased \$93.1 million, or 5.7%, to \$1.532 billion at September 30, 2018, from \$1.626 billion at December 31, 2017. The decrease in total assets was primarily due to decreases in cash and cash equivalents, loans receivable and premises held-for-sale. Cash and cash equivalents decreased \$40.7 million, or 31.9%, to \$86.9 million at September 30, 2018, from \$127.6 million at December 31, 2017. Loans decreased \$46.9 million, or 3.6%, to \$1.268 billion at September 30, 2018, from \$1.315 billion at December 31, 2017. Premises held-for-sale decreased \$5.7 million due to the sale of the Bank's office building located at 15W060 North Frontage Road, Burr Ridge, Illinois. Partially offsetting these decreases was an increase in securities of \$10.5 million, or 11.3%, to \$103.9 million at September 30, 2018, from \$93.4 million at December 31, 2017.

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. 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. 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.

Table of Contents

Our loan portfolio consists primarily of investment and business loans (multi-family, nonresidential real estate, commercial, construction and land loans, and commercial leases), which together totaled 93.8% of gross loans at September 30, 2018. Commercial loans increased by \$15.0 million, or 9.8%. Available commercial line of credit commitments increased by \$12.9 million, or 14.6%, during the nine months ended September 30, 2018. Multi-family mortgage loans decreased \$6.5 million, or 1.1%; nonresidential real estate loans decreased \$22.0 million, or 12.9%; and commercial leases decreased \$13.0 million, or 4.2%, during the nine months ended September 30, 2018. Commercial lease originations included \$32.6 million of investment-grade leases to multiple lessees from a single lessor, with an average coupon of 3.85% and an average duration of 26 months.

Our primary lending area consists of the counties in the State of Illinois where our branch offices are located, and contiguous counties. We derive the most significant portion of our revenues from these geographic areas. We also engage in multi-family mortgage lending activities in carefully selected metropolitan areas outside our primary lending area, and engage in certain types of commercial lending and leasing activities on a nationwide basis. At September 30, 2018, \$271.3 million, or 46.6%, of our multi-family mortgage loans were in the Metropolitan Statistical Area for Chicago, Illinois; \$67.2 million, or 11.6%, were in the Metropolitan Statistical Area for Dallas, Texas; \$50.9 million, or 8.7%, were in the Metropolitan Statistical Area for Denver, Colorado; \$36.9 million, or 6.3%, were in the Metropolitan Statistical Area for Tampa, Florida; \$25.8 million, or 4.4%, were in the Metropolitan Statistical Area for San Antonio, Texas; and \$14.9 million, or 2.6%, were in the Metropolitan Statistical Area for Minneapolis, Minnesota. This information reflects the location of the collateral, and does not necessarily reflect the location of the borrower.

Total liabilities decreased \$87.5 million, or 6.1%, to \$1.340 billion at September 30, 2018, from \$1.428 billion at December 31, 2017, primarily due to decreases in deposits and borrowings. Total deposits decreased \$44.3 million, or 3.3%, to \$1.296 billion at September 30, 2018, from \$1.340 billion at December 31, 2017. Retail certificates of deposit increased \$50.8 million, or 22.6%, to \$275.2 million at September 30, 2018, from \$224.4 million at December 31, 2017, compared to a decrease in wholesale certificates of deposit of \$41.3 million, or 31.4%, to \$90.3 million at September 30, 2018, from \$131.6 million at December 31, 2017. Money market accounts decreased \$33.5 million, or 11.2%, to \$266.1 million at September 30, 2018, from \$299.6 million at December 31, 2017.

Interest-bearing NOW accounts decreased \$6.1 million, or 2.1%, to \$283.6 million at September 30, 2018, from \$289.7 million at December 31, 2017. Noninterest-bearing demand deposits decreased \$8.9 million, or 3.8%, to \$225.4 million at September 30, 2018, from \$234.4 million at December 31, 2017 and savings accounts decreased \$5.3 million, or 3.3%, to \$155.2 million at September 30, 2018, from \$160.5 million at December 31, 2017. Core deposits (which consists of savings, money market, noninterest-bearing demand and NOW accounts) were 71.8% of total deposits at September 30, 2018 compared to 73.4% at December 31, 2017.

Total stockholders' equity was \$192.1 million at September 30, 2018, compared to \$197.6 million at December 31, 2017. The decrease in total stockholders' equity was due to our repurchase of 752,174 shares of our common stock during the nine months ended September 30, 2018 at a total cost of \$12.6 million and our declaration and payment of cash dividends totaling \$4.8 million during the same period. These reductions in total stockholders' equity were partially offset by net income of \$11.9 million that the Company recorded for the nine months ended September 30, 2018.

Operating Results for the Three Months Ended September 30, 2018 and 2017

Net Income. Net income was \$3.7 million for the three months ended September 30, 2018, compared to net income of \$3.6 million for the three months ended September 30, 2017. Earnings per basic and fully diluted share of common stock were \$0.22 for the three months ended September 30, 2018, compared to \$0.20 for the three months ended September 30, 2017.

Net Interest Income. Net interest income was \$13.0 million for the three months ended September 30, 2018, compared to \$12.5 million for the three months ended September 30, 2017. The increase in net interest income reflected a \$1.3 million, or 8.9%, increase in interest income, which was partially offset by a \$793,000, or 49.1%, increase in interest expense.

The increase in interest income was primarily attributable to an increase in the average yield on interest-earning assets. The yield on interest-earning assets increased 52 basis points to 4.17% for the three months ended September 30, 2018, from 3.65% for the three months ended September 30, 2017. The average yield on commercial loans and leases for the third quarter of 2018 increased to 4.68%, from 4.46% for the third quarter of 2017. The cost of interest-bearing liabilities increased 32 basis points to 0.87% for the three months ended September 30, 2018, from 0.55% for the same period in 2017. Total average interest-earning assets decreased \$72.4 million, or 4.7%, to \$1.463 billion for the three months ended September 30, 2018, from \$1.536 billion for the same period in 2017. Our net interest rate spread increased by 20 basis points to 3.30% for the three months ended September 30, 2018, from 3.10% for the same period in 2017. Our net interest margin increased by 28 basis points to 3.51% for the three months ended September 30, 2018, from 3.23% for the same period in 2017.

Table of Contents

Average Balance Sheets

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

	For the Three Months Ended September 30,						
	2018			2017			
	Average	Interest	Yield/Rate	(1)Average	Interest	Yield/Rate	(1)
	Outstanding			Outstanding			
	Balance			Balance			
	(Dollars in thousands)						
Interest-earning assets:							
Loans	\$1,274,788	\$14,248	4.43 %	\$1,331,302	\$13,345	3.98 %	
Securities	113,234	627	2.20	108,050	389	1.43	
Stock in FHLB and FRB	8,125	112	5.47	8,290	101	4.83	
Other	67,257	386	2.28	88,201	286	1.29	
Total interest-earning assets	1,463,404	15,373	4.17	1,535,843	14,121	3.65	
Noninterest-earning assets	77,118			88,594			
Total assets	\$1,540,522			\$1,624,437			
Interest-bearing liabilities:							
Savings deposits	\$156,502	71	0.18	\$159,464	48	0.12	
Money market accounts	271,401	515	0.75	304,553	307	0.40	
NOW accounts	277,342	233	0.33	278,389	139	0.20	
Certificates of deposit	354,684	1,459	1.63	369,804	925	0.99	
Total deposits	1,059,929	2,278	0.85	1,112,210	1,419	0.51	
Borrowings	38,495	130	1.34	58,112	196	1.34	
Total interest-bearing liabilities	1,098,424	2,408	0.87	1,170,322	1,615	0.55	
Noninterest-bearing deposits	225,583			232,464			
Noninterest-bearing liabilities	21,770			20,231			
Total liabilities	1,345,777			1,423,017			
Equity	194,745			201,420			
Total liabilities and equity	\$1,540,522			\$1,624,437			
Net interest income		\$12,965			\$12,506		
Net interest rate spread ⁽²⁾			3.30 %			3.10 %	
Net interest-earning assets ⁽³⁾	\$364,980			\$365,521			
Net interest margin ⁽⁴⁾			3.51 %			3.23 %	
Ratio of interest-earning assets to interest-bearing liabilities	133.23 %			131.23 %			

(1) Annualized.

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

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

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

Table of Contents

Provision for Loan Losses

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

A loan balance is classified as a loss and charged-off when it is confirmed that there is no readily apparent source of repayment for the portion of the loan that is classified as loss. Confirmation can occur upon the receipt of updated third-party appraisal valuation information indicating that there is a low probability of repayment upon sale of the collateral, the final disposition of collateral where the net proceeds are insufficient to pay the loan balance in full, our failure to obtain possession of certain consumer-loan collateral within certain time limits specified by applicable federal regulations, the conclusion of legal proceedings where the borrower's obligation to repay is legally discharged (such as a Chapter 7 bankruptcy proceeding), or when it appears that further formal collection procedures are not likely to result in net proceeds in excess of the costs to collect.

We recorded a recovery of loan losses of \$23,000 for the three months ended September 30, 2018, compared to a recovery of \$225,000 for the same period in 2017. The provision for or recovery of loan losses is a function of the allowance for loan loss methodology that we use to determine the appropriate level of the allowance for inherent loan losses after net charge-offs have been deducted. The portion of the allowance for loan losses attributable to loans collectively evaluated for impairment decreased \$263,000, or 3.1%, to \$8.1 million at September 30, 2018, from \$8.4 million at December 31, 2017. There was no reserve established for loans individually evaluated for impairment for the three months ended September 30, 2018 or for the three months ended September 30, 2017. Net charge-offs were \$53,000 for the three months ended September 30, 2018, compared to recoveries of \$477,000 for the three months ended September 30, 2017.

The allowance for loan losses as a percentage of nonperforming loans was 550.85% at September 30, 2018, compared to 499.94% at June 30, 2018.

Noninterest Income

	Three Months Ended September 30, 2018 2017 Change (Dollars in thousands)		
Deposit service charges and fees	\$1,003	\$1,018	\$ (15)
Loan fee income	71	89	(18)
Commercial mortgage brokerage fees	12	—	12
Residential mortgage banking fees	34	41	(7)
Trust and insurance commissions and annuities income	207	210	(3)
Earnings on bank owned life insurance	35	67	(32)
Other	208	198	10
Total noninterest income	\$1,570	\$1,623	\$ (53)

Noninterest income was \$1.6 million for the three months ended September 30, 2018 and 2017. Deposit service charges and loan fee income decreased \$15,000 and \$18,000, respectively, for the three months ended September 30, 2018, compared to the three months ended September 30, 2017. We recorded \$12,000 in commercial mortgage brokerage fees for the three months ended September 30, 2018 as compensation for commercial loans that we placed with other institutions. Residential mortgage banking fees decreased \$7,000 to \$34,000 for the three months ended September 30, 2018. Earnings on bank owned life insurance decreased by \$32,000, or 47.8%, to \$35,000 for the three

months ended September 30, 2018 due to the decrease in the Bank-owned life insurance investment resulting from a death benefit paid earlier in 2018. Other income increased \$10,000, or 5.1%, to \$208,000 for the three months ended September 30, 2018, compared to \$198,000 for the three months ended September 30, 2017.

Table of Contents

Noninterest Expense

	Three Months		
	Ended		
	September 30,		
	2018	2017	Change
	(Dollars in thousands)		
Compensation and benefits	\$5,120	\$5,330	\$(210)
Office occupancy and equipment	1,629	1,693	(64)
Advertising and public relations	194	167	27
Information technology	717	638	79
Supplies, telephone and postage	341	337	4
Amortization of intangibles	20	123	(103)
Nonperforming asset management	60	84	(24)
Loss (gain) on sale other real estate owned	(12)	69	(81)
Valuation adjustments of other real estate owned	1	227	(226)
Operations of other real estate owned	70	107	(37)
FDIC insurance premiums	115	150	(35)
Other	1,170	1,275	(105)
Total noninterest expense	\$9,425	\$10,200	\$(775)

Noninterest expense decreased by \$775,000, or 7.6%, to \$9.4 million for the three months ended September 30, 2018, from \$10.2 million for the same period in 2017. The decrease in noninterest expense was due in substantial part to a \$210,000 decrease in compensation and benefits expense and a \$226,000 decrease in valuation adjustments of other real estate owned. The decrease in compensation was attributed to decreased accruals for loan origination and business plan performance incentives as well as continued recording of deferred compensation for loans originated in the third quarter. Office occupancy and equipment expense decreased \$64,000, or 3.8%, to \$1.6 million for the three months ended September 30, 2018, from \$1.7 million for the same period in 2017, primarily due to a decrease in real estate taxes and lower depreciation on building and furniture and fixtures. Advertising and public relations expense increased \$27,000, or 16.2%, to \$194,000 for the three months ended September 30, 2018, from \$167,000 for the same period in 2017. Information technology expense increased \$79,000, or 12.4%, to \$717,000 for the three months ended September 30, 2018, from \$638,000 for the same period in 2017. Nonperforming asset management expense decreased \$24,000, or 28.6%, to \$60,000 for the three months ended September 30, 2018, from \$84,000 for the same period in 2017, primarily due to a decrease in legal expense related to collection activities. There were \$1,000 of valuation adjustments for OREO for the three months ended September 30, 2018, compared to \$227,000 for the same period in 2017. Operations of OREO decreased \$37,000, or 34.6%, to \$70,000 for the three months ended September 30, 2018, primarily due to decreased real estate taxes and receiver fees for property management.

Income Taxes

For the three months ended September 30, 2018, we recorded income tax expense of \$1.4 million, compared to \$594,000 for the three months ended September 30, 2017. Our combined state and federal effective tax rate for the three months ended September 30, 2018 was 27.2% versus an effective tax rate of 14.3% for the three months ended September 30, 2017. Our 2017 income tax expense was reduced by \$879,000 in the third quarter due to an increase in our Illinois income tax rate from 7.75% to 9.50%, which resulted in an increase in the deferred tax asset related to our Illinois net operating loss carryforward.

Table of Contents

Operating Results for the Nine Months Ended September 30, 2018 and 2017

Net Income. We had net income of \$11.9 million for the nine months ended September 30, 2018, compared to \$8.0 million for the nine months ended September 30, 2017. Earnings per basic and fully diluted share of common stock was \$0.68 for the nine months ended September 30, 2018, compared to \$0.44 per basic and fully diluted share for the same period in 2017.

Net Interest Income. Net interest income was \$39.0 million for the nine months ended September 30, 2018, compared to \$36.8 million for the same period in 2017. The increase in net interest income reflected a \$4.0 million, or 9.7%, increase in interest income, which was partially offset by a \$1.8 million, or 42.0%, increase in interest expense.

The increase in net interest income was primarily attributable to an increase in the average yield on interest-earning assets. The yield on interest-earning assets increased 44 basis points, or 12.2%, to 4.06% for the nine months ended September 30, 2018, from 3.62% for the nine months ended September 30, 2017. The average yield on commercial loans and leases for the nine months ended September 30, 2018 increased to 4.55%, from 4.34% for the nine months ended September 30, 2017. The cost of interest-bearing liabilities increased 24 basis points to 0.74% for the nine months ended September 30, 2018, from 0.50% for the same period in 2017. Total average interest-earning assets decreased \$34.3 million, or 2.26%, to \$1.485 billion for the nine months ended September 30, 2018, from \$1.519 billion for the same period in 2017. Our net interest rate spread increased by 20 basis points to 3.32% for the nine months ended September 30, 2018, from 3.12% for the same period in 2017. Our net interest margin increased by 27 basis point to 3.51% for the nine months ended September 30, 2018, from 3.24% for the same period in 2017.

Table of Contents

Average Balance Sheets

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

	For the Nine Months Ended September 30,							
	2018			2017				
	Average			Average				
	Outstanding	Interest	Yield/Rate	Outstanding	Interest	Yield/Rate		
	Balance		(1)	Balance		(1)		
	(Dollars in thousands)							
Interest-earning assets:								
Loans	\$1,286,766	\$42,045	4.37	%	\$1,321,051	\$39,061	3.95	%
Securities	108,216	1,637	2.02		110,399	1,095	1.33	
Stock in FHLB and FRB	8,275	328	5.30		8,563	301	4.70	
Other	81,728	1,131	1.85		79,258	675	1.14	
Total interest-earning assets	1,484,985	45,141	4.06		1,519,271	41,132	3.62	
Noninterest-earning assets	77,612				91,438			
Total assets	\$1,562,597				\$1,610,709			
Interest-bearing liabilities:								
Savings deposits	\$158,648	172	0.14		\$160,460	138	0.11	
Money market accounts	283,728	1,329	0.63		305,776	886	0.39	
NOW accounts	280,242	561	0.27		272,149	395	0.19	
Certificates of deposit	339,274	3,570	1.41		362,346	2,484	0.92	
Total deposits	1,061,892	5,632	0.71		1,100,731	3,903	0.47	
Borrowings	53,649	542	1.35		52,898	444	1.12	
Total interest-bearing liabilities	1,115,541	6,174	0.74		1,153,629	4,347	0.50	
Noninterest-bearing deposits	226,759				232,662			
Noninterest-bearing liabilities	23,073				21,379			
Total liabilities	1,365,373				1,407,670			
Equity	197,224				203,039			
Total liabilities and equity	\$1,562,597				\$1,610,709			
Net interest income		\$38,967				\$36,785		
Net interest rate spread (2)			3.32	%			3.12	%
Net interest-earning assets (3)	\$369,444				\$365,642			
Net interest margin (4)			3.51	%			3.24	%
Ratio of interest-earning assets to interest-bearing liabilities	133.12	%			131.69	%		

(1) Annualized

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

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

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

Table of Contents

Provision for Loan Losses

We recorded a recovery of loan losses of \$258,000 for the nine months ended September 30, 2018, compared to a recovery of loan losses of \$15,000 for the same period in 2017. The portion of the allowance for loan losses attributable to loans collectively evaluated for impairment decreased \$263,000, or 3.1%, to \$8.1 million at September 30, 2018, from \$8.4 million at December 31, 2017. There was no reserve established for loans individually evaluated for impairment for the nine months ended September 30, 2018 or for the same period in 2017. Net charge-offs were \$5,000 for the nine months ended September 30, 2018, compared to net recoveries of \$262,000 for the same period in 2017.

The allowance for loan losses as a percentage of nonperforming loans was 550.85% at September 30, 2018, compared to 350.04% at December 31, 2017.

Noninterest Income

	Nine Months Ended September 30,		
	2018	2017	Change
	(Dollars in thousands)		
Deposit service charges and fees	\$2,970	\$2,964	\$6
Loan fee income	231	212	19
Commercial mortgage brokerage fees	138	—	138
Residential mortgage banking fees	88	172	(84)
Loss on sales of equity securities	(14)	—	(14)
Gain on disposition of premises and equipment, net	93	—	93
Trust and insurance commissions and annuities income	670	704	(34)
Earnings on bank owned life insurance	146	196	(50)
Bank-owned life insurance death benefit	1,389	—	1,389
Other	492	526	(34)
Total noninterest income	\$6,203	\$4,774	\$1,429

Noninterest income increased by \$1.4 million, or 29.9%, to \$6.2 million for the nine months ended September 30, 2018, from \$4.8 million for the nine months ended September 30, 2017. Loan fee income increased \$19,000, or 9.0%, to \$231,000 for the nine months ended September 30, 2018, from \$212,000 for the nine months ended September 30, 2017. The increase was primarily due to increased credit risk management fees and loan commitment fees. We recorded \$138,000 in commercial mortgage brokerage fees for nine months ended September 30, 2018 as compensation for commercial loans that we placed with other institutions. Residential mortgage banking fees decreased \$84,000 to \$88,000 for the nine months ended September 30, 2018. The Company no longer originates one-to-four family residential mortgage loans. All of the loans the Company currently originates are commercial-related loans, such as multi-family, nonresidential real estate, commercial, construction and land loans, and commercial leases. On April 23, 2018, the Bank sold its office building located at 15W060 North Frontage Road, Burr Ridge, Illinois. A net gain of \$93,000 was recorded in the second quarter of 2018 in connection with the sale. In August 2018, we signed a five-year lease, expiring November 2023, for a portion of the office space in the same Burr Ridge building. Future rental payments for the duration of the lease term will be approximately \$2.2 million. Trust and insurance commissions and annuities income declined by \$34,000, or 4.8%, to \$670,000 for the nine months ended September 30, 2018, due to lower sales of annuity products and property and casualty insurance, related in part to the consolidation of our Wealth Management Department into our Trust Department. In April 2018, the Bank recorded income from a death benefit on a bank-owned life insurance policy in the amount of \$1.4 million as a result of the death of a retired Bank executive.

Table of Contents

Noninterest Expense

	Nine Months Ended September 30,		
	2018	2017	Change
	(Dollars in thousands)		
Compensation and benefits	\$16,232	\$16,792	\$(560)
Office occupancy and equipment	5,022	4,914	108
Advertising and public relations	611	807	(196)
Information technology	2,066	2,070	(4)
Supplies, telephone and postage	1,070	1,027	43
Amortization of intangibles	163	374	(211)
Nonperforming asset management	313	215	98
Loss on sale other real estate owned	56	100	(44)
Valuation adjustments of other real estate owned	27	301	(274)
Operations of other real estate owned	272	460	(188)
FDIC insurance premiums	338	462	(124)
Other	3,429	3,551	(122)
Total noninterest expense	\$29,599	\$31,073	\$(1,474)

Noninterest expense decreased by \$1.5 million, or 4.7%, to \$29.6 million for the nine months ended September 30, 2018, from \$31.1 million for the same period in 2017. Compensation and benefits expense decreased \$560,000, or 3.3%. In the first quarter of 2017, we recorded a one-time, non-cash, non-tax deductible equity compensation expense of \$1.1 million related to the termination of the Bank's ESOP and the repayment of the ESOP's Share Acquisition Loan on March 29, 2017. This decrease in compensation benefits expense was partially offset by a \$177,000 expense for a one-time \$1,000 contribution to the 401(k) accounts of certain active eligible participants with salaries and wages below a specified level, increased compensation expense resulting from an increase in full-time equivalent employees to 245 at September 30, 2018 from 236 at December 31, 2017, and increased accruals for loan origination and business plan performance incentives. Office occupancy and equipment expense increased \$108,000, or 2.2%, to \$5.0 million for the nine months ended September 30, 2018, from \$4.9 million for the same period in 2017, primarily due to a \$318,000 increase in rent expense and a \$131,000 increase in snow removal expense, offset by a decrease in building and furniture and fixtures depreciation of \$297,000. Advertising and public relations decreased by \$196,000, or 24.3%, to \$611,000 for the nine months ended September 30, 2018, from \$807,000 for the same period in 2017. Nonperforming asset management increased \$98,000 to \$313,000 for the nine months ended September 30, 2018, from \$215,000 for the same period in 2017, due in substantial part to a \$64,000 increase in legal expense resulting primarily from efforts to collect a previously charged-off loan and a \$9,000 increase in appraisal expense. Operations of OREO decreased \$188,000, or 40.9%, to \$272,000 for the nine months ended September 30, 2018, compared to \$460,000 for the same period in 2017. The decrease reflects a \$69,000 decrease in legal expenses and \$88,000 decrease in insurance and real estate tax expense.

Income Taxes

For the nine months ended September 30, 2018, we recorded \$3.9 million of income tax expense, compared to \$2.5 million for the nine months ended September 30, 2017. Our effective tax rate for the nine months ended September 30, 2018 was 24.7%, compared to 23.7% for the same period in 2017. Our effective tax rate for the nine months ended September 30, 2017 included the impact of the stock option exercises and the one-time, non-cash, non-tax deductible equity compensation expense relating to the termination of the ESOP. In addition, our 2017 income tax expense was reduced by \$879,000 in the third quarter due to an increase in our Illinois income tax rate from 7.75% to 9.50%, which resulted in an increase in the deferred tax asset related to our Illinois net operating loss carryforward.

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, we place 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 consecutive months of contractual 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

Table of Contents

actually received or the renewal of the loan has not occurred for administrative reasons. At September 30, 2018, we had no loans in this category.

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

As part of the asset classification process, we develop an exit strategy for real estate collateral or OREO by assessing overall market conditions, the current use and condition of the asset, and its highest and best use. For most income-producing real estate, we believe that investors value most highly a stable income stream from the asset; consequently, we perform a comparative evaluation to determine whether conducting a sale on an “as-is”, “as-stabilized” or “as-completed” basis is most likely to produce the highest net realizable value. If we determine that the “as-stabilized” or “as-completed” basis is appropriate, we then complete the necessary improvements or tenant stabilization tasks, with the applicable time value discount and improvement expenses incorporated into our estimates of the expected costs to sell. As of September 30, 2018, substantially all impaired real estate loan collateral and OREO were valued on an “as-is basis.”

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

Table of Contents

Nonperforming Assets Summary

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

	September 30, 2018	September 30, 2018	December 31, 2017	Quarter Change	Nine-Month Change
(Dollars in thousands)					
Nonaccrual loans:					
One-to-four family residential real estate	\$1,369	\$1,538	\$ 2,027	\$ (169)	\$ (658)
Multi-family mortgage	102	92	363	10	(261)
Consumer	—	6	—	(6)	—
	1,471	1,636	2,390	(165)	(919)
Other real estate owned:					
One-to-four family residential	634	833	827	(199)	(193)
Multi-family mortgage	276	276	—	—	276
Nonresidential real estate	74	74	1,520	—	(1,446)
Land	1	4	4	(3)	(3)
	985	1,187	2,351	(202)	(1,366)
Total nonperforming assets	\$2,456	\$2,823	\$ 4,741	\$ (367)	\$ (2,285)
Ratios:					
Nonperforming loans to total loans	0.12	% 0.13	% 0.18	%	
Nonperforming assets to total assets	0.16	0.18	0.29		

Nonperforming Assets

Nonperforming assets decreased \$2.3 million to \$2.5 million at September 30, 2018 from \$4.7 million at December 31, 2017. Three residential loans and one multi-family loan with a combined book balance of \$1.2 million were transferred from nonaccrual loans to OREO during the nine months ended September 30, 2018. We continue to experience modest quantities of defaults on residential real estate loans principally due either to the borrower's personal financial condition or deteriorated collateral value.

Liquidity and Capital Resources

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

Our primary sources of funds are deposits, principal and interest payments on loans and securities, and, to a lesser extent, wholesale borrowings, the proceeds from maturing securities and short-term investments, and the proceeds from the sales of loans and securities and lease payments. The scheduled amortization of loans and securities, as well as proceeds from borrowings, are predictable sources of funds. Other funding sources, however, such as deposit inflows, mortgage prepayments and mortgage loan sales are greatly influenced by market interest rates, economic conditions and competition. We anticipate that we will have sufficient funds available to meet current loan commitments and lines of credit and maturing certificates of deposit that are not renewed or extended. We generally remain fully invested and utilize FHLB advances as an additional sources of funds. We had \$20.0 million of FHLB advances at September 30, 2018 and \$60.0 million at December 31, 2017.

BankFinancial Corporation is a separate legal entity from BankFinancial, NA. The Company must provide for its own liquidity to pay any dividends to its shareholders and to repurchase shares of its common stock, and for other corporate purposes. Its primary source of liquidity is dividend payments it receives from the Bank. The Bank's ability to pay dividends to the Company is subject to regulatory limitations. At September 30, 2018, the Company (on an unconsolidated, stand-alone basis) had liquid assets of \$8.5 million.

As of September 30, 2018, we were not aware of any known trends, events or uncertainties that had or were reasonably likely to have a material impact on our liquidity. As of September 30, 2018, we had no other material

commitments for capital expenditures.

38

Table of Contents

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 sufficient capital to absorb unforeseen losses or write-downs that are inherent in the business risks associated with the banking industry. We seek to balance the need for higher capital levels to address such unforeseen risks and the goal to achieve an adequate return on the capital invested by our stockholders.

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

As a result of the recently enacted Economic Growth, Regulatory Relief, and Consumer Protection Act, the Federal Reserve Board is required to amend its small bank holding company and savings and loan holding company policy statement to provide that holding companies with consolidated assets of less than \$3 billion that are (i) not engaged in significant nonbanking activities, (ii) do not conduct significant off-balance sheet activities, and (iii) do not have a material amount of SEC-registered debt or equity securities, other than trust preferred securities, that contribute to an organization's complexity, will no longer be subject to regulatory capital requirements, effective no later than November 2018.

In addition, as a result of the legislation, the federal banking agencies are required to develop a "Community Bank Leverage Ratio" (the ratio of a bank's tangible equity capital to average total consolidated assets) for financial institutions with assets of less than \$10 billion. A "qualifying community bank" that exceeds this ratio will be deemed to be in compliance with all other capital and leverage requirements, including the capital requirements to be considered "well capitalized" under Prompt Corrective Action statutes. The federal banking agencies may consider a financial institution's risk profile when evaluating whether it qualifies as a community bank for purposes of the capital ratio requirement. The federal banking agencies must set the minimum capital for the new Community Bank Leverage Ratio at not less than 8% and not more than 10%. A financial institution can elect to be subject to this new definition. Prompt corrective action regulations provide five classifications: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If only adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. As of September 30, 2018 and December 31, 2017, 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 minimum capital ratios set forth in the Regulatory Capital Plans will be increased or decreased and other minimum capital requirements will be established if and as necessary. In accordance with the Regulatory Capital Plans, neither the Company nor the Bank will pursue any acquisition or growth opportunity, declare any dividend or conduct any stock repurchase that would cause the Bank's total risk-based capital ratio and/or its Tier 1 leverage ratio to fall below the established minimum capital levels or the capital levels required for capital adequacy plus the Capital Conservation Buffer ("CCB"). The minimum CCB at September 30, 2018 is 1.875% and will increase 0.625% through 2019 to 2.5%. In addition, the Company intends to continue to maintain its ability to serve as a source of financial strength to the Bank by holding at least \$5.0 million of cash or liquid assets for that purpose. As of September 30, 2018, the Bank and the Company were well-capitalized, with all capital ratios exceeding the well-capitalized requirement. There are no conditions or events that management believes have changed the Bank's prompt corrective action capitalization category.

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

Table of Contents

Actual and required capital amounts and ratios were:

	Actual		Required for Capital Adequacy Purposes		To be Well-Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
September 30, 2018						
Total capital (to risk-weighted assets):						
Consolidated	\$193,118	17.40%	\$88,788	8.00%	N/A	N/A
BankFinancial, NA	184,302	16.61	88,762	8.00	\$115,966	10.00%
Tier 1 (core) capital (to risk-weighted assets):						
Consolidated	185,015	16.67	66,591	6.00	N/A	N/A
BankFinancial, NA	176,199	15.88	66,572	6.00	92,773	8.00
Common Tier 1 (CET1)						
Consolidated	185,015	16.67	49,943	4.50	N/A	N/A
BankFinancial, NA	176,199	15.88	49,929	4.50	75,378	6.50
Tier 1 (core) capital (to adjusted average total assets):						
Consolidated	185,015	12.06	61,351	4.00	N/A	N/A
BankFinancial, NA	176,199	11.49	61,342	4.00	77,887	5.00
December 31, 2017						
Total capital (to risk-weighted assets):						
Consolidated	\$195,371	17.06%	\$91,590	8.00%	N/A	N/A
BankFinancial, NA	188,582	16.48	91,572	8.00	\$114,466	10.00%
Tier 1 (core) capital (to risk-weighted assets):						
Consolidated	187,005	16.33	68,692	6.00	N/A	N/A
BankFinancial, NA	180,216	15.74	68,679	6.00	91,572	8.00
Common Tier 1 (CET1)						
Consolidated	187,005	16.33	51,519	4.50	N/A	N/A
BankFinancial, NA	180,216	15.74	51,509	4.50	74,403	6.50
Tier 1 (core) capital (to adjusted average total assets):						
Consolidated	187,005	11.49	65,085	4.00	N/A	N/A
BankFinancial, NA	180,216	11.08	65,045	4.00	81,307	5.00

Quarterly Cash Dividends. The Company declared cash dividends of \$0.27 and \$0.20 per share for the nine months ended September 30, 2018 and September 30, 2017, respectively.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

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

The general objective of our interest rate risk management is to determine the appropriate level of risk given our business strategy and then manage that risk in a manner that is consistent with our policy to reduce, to the extent possible, the exposure of our net interest income to changes in market interest rates. Our Asset/Liability Management

Committee (“ALCO”), which consists of

40

Table of Contents

certain members of senior management, evaluates the interest rate risk inherent in certain assets and liabilities, our operating environment and capital and liquidity requirements, and modifies our lending, investing and deposit gathering strategies accordingly. The Board of Directors then reviews the ALCO's activities and strategies, the effect of those strategies on our net interest margin, and the effect that changes in market interest rates would have on the economic value of our loan and securities portfolios as well as the intrinsic value of our deposits and borrowings, and reports to the full Board of Directors.

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

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

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

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

Quantitative Analysis. The following table sets forth, as of September 30, 2018, the estimated changes in the Bank's NPV and net interest income that would result from the designated instantaneous parallel shift in the U.S. Treasury yield curve. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

Change in Interest Rates (basis points)	Estimated Decrease in NPV		Increase in Estimated Net Interest Income	
	Amount (Dollars in thousands)	Percent	Amount	Percent
+400	\$(43,445)	(16.40)%	\$293	0.55 %
+300	(27,689)	(10.45)	350	0.66
+200	(16,325)	(6.16)	372	0.70

Edgar Filing: BankFinancial CORP - Form 10-Q

+100	(7,545)	(2.85)	353	0.66
0				
-100	(2,216)	(0.84)	571	1.07

The table set forth above indicates that at September 30, 2018, in the event of an immediate 100 basis point decrease in interest rates, the Bank would be expected to experience a 0.84% decrease in NPV and a \$571,000 increase in net interest income. In the event of an immediate 200 basis point increase in interest rates, the Bank would be expected to experience a 6.16% decrease in NPV and a \$372,000 increase in net interest income. This data does not reflect any actions that we may undertake in response to

Table of Contents

changes in interest rates, such as changes in rates paid on certain deposit accounts based on local competitive factors, which could reduce the actual impact on NPV and net interest income, if any.

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

ITEM 4. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chairman, Chief Executive Officer and President and the Executive Vice President and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of September 30, 2018. Based on that evaluation, the Company's management, including the Chairman, Chief Executive Officer, and President and the Executive Vice President and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective.

During the quarter ended September 30, 2018, there have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

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

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

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

(b) Use of Proceeds. Not applicable.

(c) Repurchases of Equity Securities.

The following table sets forth information in connection with purchases of our common stock made by, or, on behalf of us, during the third quarter of 2018:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased under the Plans or Programs (1)
July 1, 2018 through July 31, 2018	21,000	\$ 17.63	21,000	224,587
August 1, 2018 through August 31, 2018	128,340	15.86	128,340	96,247
September 1, 2018 through September 30, 2018	105,445	15.99	105,445	240,802
	254,785		254,785	

On March 28, 2018, the Board extended the expiration date of the Company's share repurchase authorization from June 30, 2018 to April 30, 2019, and increased the total number of shares authorized for repurchase by 500,000 shares. On October 16, 2018 and September 6, 2018, the Board increased the total number of shares authorized for repurchase by 180,000 shares and 250,000 shares, respectively. As of September 30, 2018, the Company had repurchased 3,339,953 shares of its common stock out of the 3,580,755 shares of common stock authorized under the share repurchase authorizations, increased to 3,760,755 shares authorized on October 16, 2018. Pursuant to the share repurchase authorization, as of October 16, 2018, there are 355,658 shares of common stock authorized for repurchase through April 30, 2019.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit Number	Description
<u>31.1</u>	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<u>31.2</u>	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
<u>32</u>	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
101	The following financial statements from the BankFinancial Corporation Quarterly Report on Form 10-Q for the quarter ended September 30, 2018, formatted in Extensive Business Reporting Language (XBRL): (i) consolidated statements of financial condition, (ii) consolidated statements of operations, (iii) consolidated statements of comprehensive income, (iv) consolidated statements of changes in stockholders' equity, (v) consolidated statements of cash flows and (vi) the notes to consolidated financial statements.

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

SIGNATURES

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

**BANKFINANCIAL
CORPORATION**

Dated: October 26, 2018 By: /s/ F. Morgan Gasior

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

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