

BankFinancial CORP  
Form 10-K  
March 12, 2008

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-K**

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

**For the fiscal year ended December 31, 2007**

**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)**

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**Maryland**  
(State or Other Jurisdiction

of Incorporation)

**75-3199276**  
(I.R.S. Employer

Identification No.)

**15W060 North Frontage Road, Burr Ridge, Illinois**  
(Address of Principal Executive Offices)

**60527**  
(Zip Code)

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

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

**Title of Each Class:**  
**Common Stock, par value \$0.01 per share**

**Name of Each Exchange on Which Registered:**  
**The NASDAQ Stock Market LLC**

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

**None**

Indicate by check mark whether the issuer is a well-known seasoned issuer as defined in Rule 405 of the Securities Act of 1933. Yes  No .

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

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes  No .

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

At March 7, 2008, there were 22,031,077 shares of common stock, \$0.01 par value, outstanding.

The aggregate market value of the registrant's outstanding voting common stock held by non-affiliates on June 30, 2007, determined using a per share closing price on that date of \$15.45, as quoted on The Nasdaq Stock Market, was \$334.1 million.

### **DOCUMENTS INCORPORATED BY REFERENCE**

**None**

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**PART I**

**ITEM 1. BUSINESS**

**Forward Looking Statements**

This Annual Report on Form 10-K contains, and other periodic and special reports and press releases 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. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and are including this statement for purposes of invoking these safe harbor provisions. These forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, are generally identifiable by use of the words believe, expect, intend, anticipate, estimate, project, plan, or similar expressions. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain and actual results may differ from those predicted. Factors that could have a material adverse effect on operations and could affect management's outlook or our future prospects include, but are not limited to: higher than expected overhead, infrastructure and compliance costs, changes in market interest rates, a flattening or inversion of the yield curve, less than anticipated balance sheet growth, lack of demand for loan products, unanticipated changes in secondary mortgage market conditions, deposit flows, pricing, underwriting and other forms of competition, adverse federal or state legislative or regulatory developments, monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and Federal Reserve Board, deteriorating economic conditions that could result in increased delinquencies in our loan portfolio, the quality or composition of our loan or investment portfolios, demand for financial services and multi-family, commercial and residential real estate loans in our market area, the possible short-term dilutive effect of potential acquisitions or de novo branches, if any, changes in accounting principles, policies and guidelines, and future adverse developments concerning Freddie Mac or the Federal Home Loan Bank of Chicago. These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. We do not undertake any obligation to update any forward-looking statement in the future, or to reflect circumstances and events that occur after the date on which the forward-looking statement was made.

**BankFinancial Corporation**

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

As part of the mutual-to-stock conversion, BankFinancial Corporation, the Maryland corporation, sold 24,466,250 shares of common stock in a subscription offering for \$10.00 per share. The separate corporate existences of BankFinancial MHC and BankFinancial Corporation, the federal corporation, ceased upon the completion of the mutual-to-stock conversion. For a further discussion of the mutual-to-stock conversion, see our Prospectus as filed on April 29, 2005 with the Securities and Exchange Commission ("SEC") pursuant to Rule 424(b)(3) of the Rules and Regulations of the Securities Act of 1933 (File Number 333-119217).

BankFinancial Corporation, the Maryland corporation, did not engage in any business prior to the completion of the mutual-to-stock conversion on June 23, 2005. Consequently, this Annual Report on Form 10-K reflects the financial condition and operating results of BankFinancial MHC and BankFinancial Corporation, the federal corporation, and their subsidiaries, including the Bank, until June 23, 2005, and of BankFinancial Corporation, the Maryland corporation, and its subsidiaries, including the Bank, thereafter. The words Company, we and our thus are intended to refer to BankFinancial MHC, BankFinancial Corporation, the federal corporation, and their subsidiaries with respect to matters and time periods occurring on or before June 23, 2005, and to BankFinancial Corporation, the Maryland corporation, and its subsidiaries, with respect to matters and time periods occurring thereafter.

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

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

The Bank is a full-service, community-oriented savings bank principally engaged in the business of commercial, family and personal banking, and offers our customers a broad range of loan, deposit, and other financial products and services through 18 full-service banking offices located in Cook, DuPage, Lake and Will Counties, Illinois, and through our Internet Branch, [www.bankfinancial.com](http://www.bankfinancial.com).

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

The Bank's primary lending area consists of the counties where our branch offices are located, and contiguous counties in the State of Illinois. We derive substantially all of our revenues from these geographic areas. The Bank's primary market for deposits is currently concentrated around the areas where our full-service banking offices are located.

The Bank was organized in 1924, and was operated as a traditional savings bank until 2000, when we implemented a strategy to transform the Bank into a multi-faceted financial institution with a diversified balance sheet, enhanced capabilities in commercial banking products and services, an expanded geographic presence in the Chicago metropolitan area, and managerial and technological resources and an infrastructure capable of supporting future growth. In furtherance of this strategy, we have actively sought to change the composition of our loans and deposits, expand our multi-family and commercial real estate lending activities, and implement additional commercial lending and leasing capabilities and product lines. We also acquired Success Bancshares, Inc. and its subsidiary, Success National Bank in 2001, and University National Bank in Chicago's Hyde Park community on April 5, 2006. See Acquisition .

### **Lending Activities**

Our loan portfolio consists primarily of investment and business loans (multi-family, nonresidential real estate, commercial, construction and land loans, and commercial leases), which represent 72.0% of our loan portfolio. At December 31, 2007, \$291.4 million, or 23.1%, of our total loan portfolio consisted of multi-family mortgage loans; \$325.9 million, or 25.8%, of our total loan portfolio consisted of nonresidential real estate loans; \$83.2 million, or 6.6%, of our total loan portfolio consisted of commercial loans; \$144.8 million, or 11.5%, of our total loan portfolio consisted of commercial leases; \$64.5 million, or 5.1%, of our total loan portfolio consisted of construction and land loans; and \$345.2 million, or 27.3%, of our total loan portfolio consisted of one- to four-family residential mortgage loans, including home equity loans and lines of credit and other second mortgage loans.

### **Deposit Activities**

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

At December 31, 2007, our deposits totaled \$1.074 billion. Interest-bearing deposits totaled \$962.1 million and noninterest-bearing demand deposits totaled \$111.6 million, which included \$5.0 million in internal checking accounts such as bank cashier checks and money orders, and \$3.5 million in title insurance escrow funds. Savings, money market and NOW deposits totaled \$654.5 million, and certificates of deposit totaled \$307.6 million, of which \$269.5 million had maturities of one year or less.

## Related Products and Services

The Bank's Wealth Management Group provides investment, financial planning and other wealth management services to our customers through arrangements with a third-party broker-dealer. The Bank's wholly-owned subsidiary, Financial Assurance Services, Inc., sells life insurance, fixed annuities, property and casualty insurance and other insurance products on an agency basis, and also offers title insurance and title agency services through its Financial Title Services Division. During the year ended December 31, 2007, Financial Assurance Services reported net income of \$239,000, and had 14 employees. The Bank's other wholly-owned subsidiary, BF Asset Recovery Corporation, is in the business of holding title to certain Bank-owned real estate, and had no net income or loss for the year ended December 31, 2007.

## Acquisition

On April 5, 2006, the Company completed its acquisition of University National Bank, a privately held community bank with approximately \$113 million in assets and \$104 million in deposits, and two banking offices in the Hyde Park community in Chicago, Illinois, for approximately \$24 million in cash pursuant to the terms of a Stock Purchase Agreement with University Bancorporation dated November 29, 2005. Immediately upon the completion of the stock purchase, University National Bank was merged into the Bank. The acquisition, which was accounted for under the purchase method of accounting, resulted in goodwill of \$11.7 million and an other intangible of \$3.3 million. The transaction was treated, for federal and state income tax purposes, as a purchase of University National Bank's assets pursuant to applicable provisions of the Internal Revenue Code, making the goodwill and core deposit intangible arising from the transaction tax-deductible over a period of 15 years. University National Bank's results of operations have been included in the Company's results of operations only since the effective date of the acquisition.

## Website and Stockholder Information

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

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

## Competition

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

We seek to meet this competition by emphasizing personalized banking and local decision-making. Specifically, we promote and maintain relationships and build customer loyalty within local communities by emphasizing decentralized regional management and by focusing our marketing and community involvement on the specific needs of individual neighborhoods. In addition, we, from time to time, seek to meet competition for loans by offering our current and prospective borrowers preferred rates and terms on deposit products for new lending business. We do not rely on any individual, group or entity for a material portion of our deposits.

## Employees

At December 31, 2007, we had 393 full-time employees and 31 part-time employees. The employees are not represented by a collective bargaining unit and we consider our working relationship with our employees to be good.

## Supervision And Regulation

### General

As a federally chartered savings bank, the Bank is regulated and supervised by the Office of Thrift Supervision ( OTS ) and the Federal Deposit Insurance Corporation ( FDIC ). This regulation and supervision establish a comprehensive framework of activities in which a financial institution may engage, and is intended primarily for the protection of the FDIC 's deposit insurance funds and depositors. Under this system of federal regulation, financial institutions are periodically examined to ensure that they satisfy applicable standards with respect to their capital adequacy, assets, management, earnings, liquidity and sensitivity to market interest rates. After completing an examination, the primary federal regulator of the institution critiques the financial institution 's operations in a report of examination and assigns its rating (known as an institution 's CAMELS rating). Under federal law, an institution may not disclose its CAMELS rating to the public.

The Bank is a member of, and owns stock in, the Federal Home Loan Bank of Chicago ( FHLBC ), which is one of the 12 regional banks in the Federal Home Loan Bank System. The Bank also is regulated to a lesser extent by the Board of Governors of the Federal Reserve System with regard to reserves it must maintain against deposits and other matters. The OTS examines the Bank and prepares reports for the consideration of its Board of Directors on any identified operating deficiencies. The Bank 's relationship with its depositors and borrowers also is regulated to a great extent by both federal and state laws, especially in matters concerning the ownership of deposit accounts and the form and content of the Bank 's loan documents.

There can be no assurance that laws, rules and regulations will not change in the future, which could make compliance more difficult or expensive or otherwise adversely affect our business, financial condition, results of operations or prospects. Any change in these laws or regulations, or in regulatory policy, whether by the FDIC, the OTS, the Board of Governors of the Federal Reserve System or Congress, could have a material adverse impact on the Company, the Bank and their respective operations.

### Federal Banking Regulation

**Business Activities.** A federal savings bank derives its lending and investment powers from the Home Owners ' Loan Act, as amended, and the regulations of the OTS. Under these laws and regulations, the Bank may invest in mortgage loans secured by residential and nonresidential real estate, commercial business and consumer loans, certain types of securities and certain other loans and assets. The Bank also may establish subsidiaries that may engage in activities not otherwise permissible for the Bank directly, including real estate investment and insurance agency activities.

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

The risk-based capital standard for savings banks requires the maintenance of Tier 1, or core capital, and total capital (which is defined as core capital and supplementary capital) to risk-weighted assets of at least 4% and 8%, respectively. In determining the amount of risk-weighted assets, all assets, including certain off-balance sheet assets, are multiplied by a risk-weight factor of 0% to 100%, assigned by the OTS capital regulation based on the risks inherent in the type of asset. Core capital is defined as common stockholders ' equity (including retained earnings), certain noncumulative perpetual preferred stock and related surplus and minority interests in equity accounts of consolidated subsidiaries, less intangibles other than certain mortgage servicing rights and credit card relationships.

The components of supplementary capital currently include cumulative perpetual preferred stock, long-term preferred stock, mandatory convertible securities, subordinated debt and intermediate-term preferred stock, allowance for loan and lease losses up to a maximum of 1.25% of risk-weighted assets and up to 45% of net unrealized gains on available-for-sale equity securities with readily determinable fair market values. Overall, the amount of supplementary capital included as part of total capital cannot exceed 100% of core capital.

At December 31, 2007, the Bank's capital exceeded all applicable requirements.

**Loans to One Borrower.** A federal savings bank generally may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of unimpaired capital and surplus. An additional amount may be loaned, equal to 10% of unimpaired capital and surplus, if the loan is secured by readily marketable collateral, which generally does not include real estate. As of December 31, 2007, the Bank was in compliance with the loans-to-one-borrower limitations.

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

Qualified thrift investments include various types of loans made for residential and housing purposes, investments related to those purposes, including certain mortgage-backed and related securities, and loans for personal, family, household and certain other purposes up to a limit of 20% of portfolio assets. Qualified thrift investments also include 100% of an institution's credit card loans, education loans and small business loans. The Bank also may satisfy the QTL test by qualifying as a domestic building and loan association as defined in the Internal Revenue Code of 1986. At December 31, 2007, the Bank maintained approximately 68.76% of its portfolio assets in qualified thrift investments, and as of that date, satisfied the QTL test. A savings bank that fails the QTL test must either convert to a bank charter or operate under specified restrictions, including limits on growth, branching, new investment, FHLB advances and dividends. The OTS order approving our mutual-to-stock conversion requires us to maintain our federal savings bank charter until at least June 23, 2008.

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

the total capital distributions for the applicable calendar year exceed the sum of the savings bank's net income for that year to date plus the savings bank's retained net income for the preceding two years;

the savings bank would not be at least adequately capitalized following the distribution;

the distribution would violate any applicable statute, regulation, agreement or OTS-imposed condition; or

the savings bank is not eligible for expedited treatment of its filings.

Even if an application is not otherwise required, every savings bank that is a subsidiary of a holding company must still file a notice with the OTS at least 30 days before the board of directors declares a dividend or approves a capital distribution.

The OTS may disapprove a notice or application if:

the savings bank would be undercapitalized following the distribution;

the proposed capital distribution raises safety and soundness concerns; or





the capital distribution would violate a prohibition contained in any statute, regulation or agreement.

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

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

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

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

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

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

are based, in part, on the amount of the Bank's capital. In addition, extensions of credit in excess of certain limits must be approved by the Bank's Board of Directors. The Bank does not extend credit to its directors and executive officers.

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

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

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

well-capitalized (at least 5% leverage capital, 6% tier 1 risk-based capital and 10% total risk-based capital);

adequately capitalized (at least 4% leverage capital, 4% tier 1 risk-based capital and 8% total risk-based capital);

undercapitalized (less than 3% leverage capital, 4% tier 1 risk-based capital or 8% total risk-based capital);

significantly undercapitalized (less than 3% leverage capital, 3% tier 1 risk-based capital or 6% total risk-based capital); and

critically undercapitalized (less than 2% tangible capital).

Generally, the banking regulator is required to appoint a receiver or conservator for a savings bank that is critically undercapitalized. The regulation also provides that a capital restoration plan must be filed with the OTS within 45 days of the date a bank receives notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. In addition, numerous mandatory supervisory actions become immediately applicable to the savings bank, including, but not limited to, restrictions on growth, investment activities, capital distributions and affiliate transactions. The OTS may also take any one of a number of discretionary supervisory actions against undercapitalized savings banks, including the issuance of a capital directive and the replacement of senior executive officers and directors.

At December 31, 2007, the Bank met the criteria for being considered well-capitalized.

**Insurance of Deposit Accounts.** Deposit accounts in the Bank are insured by the Deposit Insurance Fund ( DIF ) of the FDIC (effective March 31, 2006, the FDIC merged the Bank Insurance Fund and the Savings Insurance Fund into a single insurance fund, the DIF), generally up to a maximum of \$100,000 per separately insured depositor and up to a maximum of \$250,000 for self-directed retirement accounts. The Bank's deposits, therefore, are subject to FDIC deposit insurance assessments. The FDIC has adopted a risk-based system for determining deposit insurance assessments. The FDIC is authorized to raise the assessment rates as necessary to maintain the required ratio of reserves to insured deposits of 1.25%. In addition, all FDIC-insured institutions must pay assessments to the FDIC at an annual rate of approximately 0.0122% of insured deposits to fund interest payments on bonds maturing in 2017 that were issued by a federal agency to recapitalize the predecessor to the Savings Association Insurance Fund.

Federal deposit insurance legislation adopted in 2006 required, among other things, the merger of the Savings Association Insurance Fund and the Bank Insurance Fund into a unified insurance deposit fund, an increase in the amount of federal deposit insurance coverage per separately insured deposits (with a cost of living adjustment to become effective in five years), and the reserve ratio to be modified to provide for a range between 1.15% and 1.50% of estimated insured deposits.

On November 2, 2006, the FDIC adopted final regulations that calculate deposit insurance assessments based on risk. The final regulations, which became effective on January 1, 2007, are intended to enable the FDIC to more closely tie each insured depository institution's deposit insurance assessments to the risk it poses to the federal deposit insurance fund. The regulations establish four risk categories based supervisory ratings, capital and other financial ratios, and, if applicable, long-term debt issuer ratings. The Bank is in the lowest risk category, Risk Category I, and the base assessment rates for insured depository institutions in Risk Category I range from five and seven cents for every \$100 of domestic deposits. The Federal Deposit Insurance Reform Act of 2005 authorized eligible insured depository institutions such as the Bank to receive a one-time credit against future deposit insurance assessments. The FDIC has determined that the Bank's one-time assessment credit was \$1.8 million at December 31, 2006, with \$1.3 million remaining at December 31, 2007. The one-time assessment credit is applied to pay deposit insurance assessments as they become due. The FDIC has also adopted final regulations designating the reserve ratio for the deposit insurance fund during 2007 at 1.25% of estimated insured deposits.

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

**Federal Home Loan Bank System.** The Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The Federal Home Loan Bank System provides a central credit facility primarily for member institutions. As a member of the FHLBC, the Bank is required to acquire and hold shares of capital stock in the FHLBC in an amount at least equal to 1% of the aggregate principal amount of its unpaid residential mortgage loans and similar obligations at the beginning of each year, or 1/20 of its borrowings from the FHLBC, whichever is greater. As of December 31, 2007, the Bank was in compliance with this requirement.

#### **Federal Reserve System**

Federal Reserve Board regulations require savings banks to maintain noninterest-earning reserves against their transaction accounts, such as negotiable order of withdrawal and regular checking accounts. At December 31, 2007, the Bank was in compliance with these reserve requirements. The balances maintained to meet the reserve requirements imposed by the Federal Reserve Board may be used to satisfy liquidity requirements imposed by the OTS.

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

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

### **Holding Company Regulation**

The Company is a unitary savings and loan holding company, subject to regulation and supervision by the OTS. The OTS has enforcement authority over the Company and its non-savings institution subsidiaries. Among other things, this authority permits the OTS to restrict or prohibit activities that are determined to be a risk to the Bank.

Under prior law, a unitary savings and loan holding company generally had no regulatory restrictions on the types of business activities in which it could engage, provided that its subsidiary savings bank was a qualified thrift lender. The Gramm-Leach-Bliley Act of 1999, however, restricts the activities of unitary savings and loan holding companies not existing on, or applied for before, May 4, 1999, to those permissible for financial holding companies or for multiple savings and loan holding companies. The Company is not a grandfathered unitary savings and loan holding company, and therefore is limited to the activities permissible for financial holding companies or for multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, including underwriting equity securities and insurance, incidental to financial activities or complementary to a financial activity. A multiple savings and loan holding company is generally limited to activities permissible for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act, subject to the prior approval of the OTS, and certain additional activities authorized by OTS regulations.

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

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

The Sarbanes-Oxley Act of 2002 was enacted in response to public concerns regarding corporate accountability in connection with certain accounting scandals. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The Sarbanes-Oxley Act generally applies to all companies that file or are required to file periodic reports with the Securities and Exchange Commission, under the Securities Exchange Act of 1934.

The Sarbanes-Oxley Act includes specific additional disclosure requirements, requires the Securities and Exchange Commission and national securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules, and mandates further studies of certain issues by the Securities and Exchange Commission. The Sarbanes-Oxley Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

## **Federal Securities Laws**

The Company's common stock is registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended. The Company is subject to the information, proxy solicitation, insider trading restrictions and other requirements of the Securities Exchange Act of 1934.

## **Taxation**

**Federal Taxation.** The Company and the Bank are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal taxation is intended only to summarize material federal income tax matters and is not a comprehensive description of the tax rules applicable to the Company and the Bank.

**Method of Accounting.** For federal income tax purposes, the Company currently reports its income and expenses on the accrual method of accounting and uses a tax year ending December 31 for filing its consolidated federal income tax returns. The Small Business Protection Act of 1996 eliminated the use of the reserve method of accounting for bad debt reserves by savings institutions, effective for taxable years beginning after 1995.

**Bad Debt Reserves.** Prior to the Small Business Protection Act of 1996, the Bank was permitted to establish a reserve for bad debts for tax purposes and to make annual additions to the reserve. These additions could, within specified formula limits, be deducted in arriving at the Bank's taxable income. As a result of the Small Business Protection Act of 1996, the Bank must use the specific charge off method in computing its bad debt deduction for tax purposes.

**Taxable Distributions and Recapture.** Prior to the Small Business Protection Act of 1996, bad debt reserves created prior to 1988 were subject to recapture into taxable income if the Bank failed to meet certain thrift asset and definition tests. The Small Business Protection Act of 1996 eliminated these thrift-related recapture rules. However, under current law, pre-1988 reserves remain subject to tax recapture should the Bank make certain distributions from its tax bad debt reserve or cease to maintain a financial institution charter. At December 31, 2007, the Bank's total federal pre-1988 reserve was approximately \$14.9 million. This reserve reflects the cumulative effects of federal tax deductions by the Bank for which no federal income tax provision has been made.

**Alternative Minimum Tax.** The Internal Revenue Code of 1986, as amended, imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences, referred to as alternative minimum taxable income. The alternative minimum tax is payable to the extent alternative minimum taxable income is in excess of an exemption amount. Net operating losses can, in general, offset no more than 90% of alternative minimum taxable income. Our alternative minimum tax credits were fully utilized in 2007.

**Net Loss Carryovers.** A financial institution may carry back net operating losses to the preceding two taxable years (five years for losses incurred in 2001 and 2002) and forward to the succeeding 20 taxable years. At December 31, 2007, the Company had no net operating loss carryforward for federal income tax purposes. At December 31, 2007, the Company included in deferred tax assets a \$876,000 asset for capital loss carryforwards, which expires in 2011. Based upon projections of future taxable income, including capital gains, management believes that it is more likely than not that the deferred tax assets will be fully realized and thus a valuation allowance is not needed.

**Corporate Dividends.** We may exclude from our income 100% of dividends received from the Bank as a member of the same affiliated group of corporations.

**State and Local Taxation.** We pay income tax to the State of Illinois. As a Maryland business corporation, we are required to file annual returns and pay annual fees to the State of Maryland, but these fees are not material in amount. At December 31, 2007, the Company had no net operating loss carryforward for state income tax purposes.

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**ITEM 1A. RISK FACTORS**

The risks set forth below may adversely affect our business, financial condition and operating results. In addition to the risks set forth below and the other risks described in Item 1, Business, Forward-Looking Statements, and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, there may also be additional risks and uncertainties that are not currently known to us or that we currently deem to be immaterial that could materially and adversely affect our business, financial condition or operating results. As a result, past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

**Changes in Market Interest Rates Could Adversely Affect Our Financial Condition and Results of Operations**

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

**Our Return on Stockholders' Equity Will Continue to Be Low In the Near Future as a Result of the 2005 Subscription Offering**

Net income divided by average stockholders' equity, known as return on equity, is a ratio that many investors use to compare the performance of a financial institution to its peers. Our capital remains relatively high by industry standards pending a more optimal deployment of the additional capital raised in our mutual-to-stock conversion. Until we can increase our net interest income and noninterest income, we expect our return on equity to continue to be below the industry average, which may negatively affect the value of our shares of common stock.

**Our Nonresidential Real Estate Loans, Multi-family Mortgage Loans, Construction and Land Loans, Commercial Loans and Commercial Leases Expose Us to Increased Credit Risks**

At December 31, 2007, our portfolio of nonresidential real estate loans totaled \$325.9 million, or 25.8% of total loans; our portfolio of multi-family mortgage loans totaled \$291.4 million, or 23.1% of total loans; our portfolio of construction and land loans totaled \$64.5 million, or 5.1% of total loans; our portfolio of commercial loans totaled \$83.2 million, or 6.6% of total loans; and our portfolio of commercial leases totaled \$144.8 million, or 11.5% of total loans. We plan to continue to originate these types of loans and retain them in our portfolio, although we may participate portions of some of these loans to other financial institutions. These types of loans generally have greater credit risk than one- to four-family residential mortgage loans because repayment of the loans often depends on the successful business operations of the borrower. These loans typically have larger loan balances to single borrowers or groups of related borrowers compared to one- to four-family residential mortgage loans. Many of our borrowers also have more than one nonresidential real estate, multi-family mortgage, construction or commercial loan or lease outstanding with us. Consequently, an adverse development involving one or more loans or credit relationships can expose us to significantly greater risk of loss compared to an adverse development involving a one- to four-family residential mortgage loan.

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**Our Concentration of Loans within Certain Segments of the Healthcare Industry Exposes Us to Increased Credit Risk**

At December 31, 2007, we had \$53.7 million of loans to healthcare providers, including loans to nursing homes and hospice care companies and leases to hospitals for equipment. These loans represented 4.3% of our total loan portfolio as of that date. Of these loans, \$18.6 million, or 34.7%, were collateralized by real estate. The remainder consisted of working capital lines of credit secured by government accounts receivable, of which we are a joint payee, or by leased equipment. Loans to healthcare providers have unique credit risks. A healthcare provider's income stream is subject to many factors beyond the control of the healthcare provider, including the risk that the provider will not be reimbursed for all services provided. The State of Illinois has experienced budget shortfalls in recent years, causing delays in state reimbursement for healthcare costs. Government reimbursement rates are also subject to change, including retroactive adjustments. For example, a significant overpayment to a healthcare provider can result in the provider owing significant governmental repayments to the federal or state government. A healthcare provider's profitability also depends on its ability to maintain certain levels of occupancy. Unexpected declines in occupancy rates can restrict a provider's cash flow. Any of these factors can impair the ability of our healthcare provider borrowers to make loan repayments, which could result in significant loss to us.

At December 31, 2007, we had not taken any charge-offs within this segment of our loan portfolio, but we have established a specific loan loss reserve allowance in the amount of \$259,000 for loans to one borrower with an aggregate principal balance of \$6.3 million. The loans to this borrower are also partially secured by additional collateral, including home equity and other personal assets. In addition, based on weaknesses in the financial performance of, and untimely or incomplete financial statements for, certain nursing homes operated by another borrower, we classified as substandard loans to this other borrower, which had an aggregate principal balance of \$3.2 million, even though we did not establish a specific loan loss allowance for these loans. These loans were current on their loan payments to us as of December 31, 2007.

**We Could Record Future Losses on Our Holdings of Freddie Mac Preferred Stock**

We own shares of Freddie Mac preferred stocks with an adjusted cost basis of \$38.3 million, and a fair value of \$31.2 million at December 31, 2007, based on quoted market prices for these securities. The quoted market prices for these securities have been very volatile in recent months on generally low trading volumes. The adjusted cost basis takes into account the pre-tax impairment losses that we previously recorded for these securities in accordance with Securities and Exchange Commission Codification of Staff Accounting Bulletins, Topic 5: Miscellaneous Accounting - Item M, Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities. A number of factors or combinations of factors could cause us to conclude in one or more future reporting periods that an unrealized loss that exists with respect to these securities constitutes an impairment that is other than temporary. These factors include, but are not limited to, an increase in the severity of the unrealized loss on a particular security, an increase in the continuous duration of the unrealized loss without an improvement in value, a change in our intent or ability to hold the security for a period of time sufficient to allow for the forecasted recovery, or changes in market conditions and/or industry or issuer specific factors that would render us unable to forecast a full recovery in value, including adverse developments concerning Freddie Mac. In addition, the fair value that we have recorded for these securities, which is based on quoted market prices, may be different from the actual price for which we could sell the securities in a market transaction due to such factors as, volatility or illiquidity in the financial markets or for these securities, or the possibility of block discounts.

**If Our Allowance for Loan Losses is Not Sufficient to Cover Actual Loan Losses, Our Earnings Could Decrease**

In the event that our loan customers do not repay their loans according to the terms of the loans, and the collateral securing the repayment of these loans is insufficient to cover any remaining loan balance, we could experience significant loan losses or increase our provision for loan losses or both, which could have a material adverse effect on our operating results. We make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets, if any, serving as collateral for the repayment of our loans. At December 31, 2007, our allowance for loan losses was \$11.1 million, representing 0.87% of total loans and 91.7% of nonperforming loans as of that date. In determining the amount of our allowance for loan losses, we rely on our loan quality reviews, our experience and our evaluation of economic



conditions, among other factors. We also make assumptions concerning our legal positions and the priority of our interests in contested legal or bankruptcy proceedings, and at times we may lack sufficient information to establish specific reserves for loans involved in such proceedings.

#### **Our Ability to Successfully Conduct Acquisitions Will Affect Our Ability to Grow Our Franchise and Compete Effectively in Our Marketplace**

On April 5, 2006, we completed the acquisition of University National Bank. We will also consider the possible acquisition of other banks, thrifts and other financial services companies to supplement internal growth. Our efforts to acquire other financial institutions and financial service companies may not be successful. Numerous potential acquirors exist for most acquisition candidates, creating intense competition, which particularly affects the purchase price for which the institution can be acquired. In many cases, our competitors have significantly greater resources than we have, and greater flexibility to structure the consideration for the transaction. We may not participate in specific acquisition opportunities if we consider the proposed transaction unacceptable. We also may not be the successful bidder in acquisition opportunities that we pursue due to the willingness or ability of other potential acquirors to propose a higher purchase price or more attractive terms and conditions than we are willing or able to propose. If we are unable to or do not conduct acquisitions, our ability to deploy effectively the capital we raised in the offering, expand our geographic presence and improve our results of operations could be adversely affected.

#### **The Risks Presented by the Acquisition of Other Institutions Could Adversely Affect Our Financial Condition and Results of Operations**

If we are successful in conducting acquisitions, we will be presented with many risks that could have a material adverse effect on our financial condition and results of operations. An institution that we acquire may have unknown asset quality issues or unknown or contingent liabilities that we did not discover or fully recognize in the due diligence process, thereby resulting in unanticipated losses. The acquisition of other institutions typically requires the integration of different corporate cultures, loan and deposit products, pricing strategies, data processing systems and other technologies, accounting, internal audit and financial reporting systems, operational processes, policies, procedures and internal controls, marketing programs and personnel of the acquired institution in order to make the transaction economically advantageous. The integration process is complicated and time consuming, and could divert our attention from other business concerns and be disruptive to our customers and the customers of the acquired institution. Our failure to successfully integrate an acquired institution could result in the loss of key customers and employees, and prevent us from achieving expected synergies and cost savings. Acquisitions also result in professional fees, purchase price adjustments, the amortization of core deposit intangibles and other expenses that could adversely affect our earnings, and in goodwill that could become impaired, requiring us to recognize further charges. We may finance acquisitions with borrowed funds, thereby increasing our leverage and reducing our liquidity, or with potentially dilutive issuances of equity securities.

#### **Since Our Business is Concentrated in the Chicago Metropolitan Area, a Downturn in the Economy of This Area May Adversely Affect Our Business**

Our lending and deposit gathering activities are concentrated primarily in the Chicago metropolitan area. Our success depends on the general economic conditions of this area and surrounding areas. In addition, many of the loans in our loan portfolio are secured by real estate located in the Chicago metropolitan area. Negative conditions in the real estate markets where collateral for a mortgage loan is located could adversely affect the borrower's ability to repay the loan and the value of the collateral securing the loan. Real estate values are affected by various other factors, including supply and demand, changes in general or regional economic conditions, interest rates, governmental rules or policies and natural disasters. Adverse changes in the regional and general economy could also reduce our growth rate, impair our ability to collect loans and generally have a negative effect on our financial condition and results of operations.

#### **Non-Compliance with USA PATRIOT Act, Bank Secrecy Act, or Other Laws and Regulations Could Result in Fines or Sanctions, and Curtail Expansion Opportunities**

Financial institutions are required under the USA PATRIOT and Bank Secrecy Acts to develop programs to prevent financial institutions from being used for money laundering and terrorist activities. Financial institutions are also

obligated to file suspicious activity reports with the U.S. Treasury Department's Office of Financial Crimes Enforcement Network if such activities are detected. These rules also require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure or the inability to comply with these regulations could result in fines or penalties, curtailment of expansion opportunities, intervention or sanctions by regulators and costly litigation or expensive additional controls and systems. During the last few years, several banking institutions have received large fines for non-compliance with these laws and regulations. We have developed policies and continue to augment procedures and systems designed to assist in compliance with these laws and regulations.

**The Bank's Ability to Pay Dividends is Subject to Regulatory Limitations Which, to the Extent the Company Requires Such Dividends in the Future, May Affect its Ability to Pay Dividends**

The Company is a separate legal entity from its subsidiaries and does not have significant operations of its own. Dividends from the Bank provide a significant source of cash for the Company. The availability of dividends from the Bank is limited by various statutes and regulations. It is possible, depending upon the financial condition of the Bank and other factors, that the OTS, as the Bank's primary regulator, could assert that the payment of dividends or other payments by the Bank are an unsafe or unsound practice. In the event the Bank is unable to pay dividends to the Company, the Company may not be able to pay dividends on its common stock. Consequently, the potential inability to receive dividends from the Bank could adversely affect the Company's financial condition, results of operations and prospects.

**Our Future Success Is Dependent On Our Ability To Compete Effectively In The Highly Competitive Banking Industry**

We face substantial competition in all phases of our operations from a variety of different competitors. Our future growth and success will depend on our ability to compete effectively in this highly competitive environment. To date, we have grown our business successfully by focusing on our geographic markets and emphasizing the high level of service and responsiveness desired by our customers. We compete for loans, deposits and other financial services with other commercial banks, thrifts, credit unions, brokerage houses, mutual funds, insurance companies, real estate conduits, and specialized finance companies. Many of our competitors offer products and services that we do not offer, and many have substantially greater resources and lending limits, name recognition and market presence that benefit them in attracting business. In addition, larger competitors may be able to price loans and deposits more aggressively than we do, and smaller newer competitors may also be more aggressive in pricing loans and deposits in order to increase their market share. Some of the financial institutions and financial services organizations with which we compete are not subject to the extensive regulations imposed on savings banks and their holding companies. As a result, these nonbank competitors have certain advantages over us in accessing funding and in providing various financial services.

**Various Factors May Make Takeover Attempts That You Want to Succeed More Difficult to Achieve, Which May Affect the Value of Shares of Our Common Stock**

Provisions of our articles of incorporation and bylaws, federal regulations, Maryland law and various other factors may make it more difficult for companies or persons to acquire control of the Company without the consent of our board of directors. You may want a takeover attempt to succeed because, for example, a potential acquiror could offer a premium over the then prevailing price of our shares of common stock. The OTS regulations prohibit, for three years following the completion of a mutual-to-stock conversion, the direct or indirect acquisition of more than 10% of any class of equity security of a converted savings institution without the prior approval of the OTS. Provisions of our articles of incorporation and bylaws also may make it difficult to remove our current board of directors or management if our board of directors opposes the removal. We have elected to be subject to the Maryland Business Combination Act, which places restrictions on mergers and other business combinations with large stockholders. In addition, our articles of incorporation provide that certain mergers and other similar transactions, as well as amendments to our articles of incorporation, must be approved by stockholders owning at least two-thirds of our shares of common stock entitled to vote on the matter unless first approved by at least two-thirds of the number of our authorized directors, assuming no vacancies. If approved by at least two-thirds of the number of our authorized directors, assuming no vacancies, the action must still be approved by a majority of our shares entitled to vote on the matter. In addition, a director can be removed from office, but only for cause, if such

removal is approved by stockholders owning at least two-thirds of our shares of common stock entitled to vote on the matter, unless first approved by at least two-thirds of the number of our authorized directors (excluding the director whose removal is sought), assuming no vacancies. If approved by at least two-thirds of the number of our authorized directors, assuming no vacancies, the removal may be with or without cause, but must still be approved by a majority of our voting shares entitled to vote on the matter. Additional provisions include limitations on the voting rights of any beneficial owners of more than 10% of our common stock. Our bylaws, which can only be amended by the board of directors, also contain provisions regarding the timing, content and procedural requirements for stockholder proposals and nominations.

**We Continually Encounter Technological Change, and May Have Fewer Resources Than Many of Our Competitors to Continue to Invest In Technological Improvements**

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

**Our Business May Be Adversely Affected by the Highly Regulated Environment In Which We Operate**

We are subject to extensive federal and state legislation, regulation, examination and supervision. Recently enacted, proposed and future legislation and regulations could have an adverse effect on our business and operations. Our success depends on our continued ability to comply with these laws and regulations. Some of these regulations may increase our costs. While we cannot predict what effect any future changes in these laws or regulations or their interpretations would have on us, these changes or interpretations may adversely affect our future operations.

**Trading Activity in the Company's Common Stock Could Result in Material Price Fluctuations**

It is possible that trading activity in the Company's common stock, including short-selling or significant sales by current stockholders, could result in material price fluctuations of the price per share of the Company's common stock. In addition, such trading activity and the resultant volatility could make it more difficult for the Company to sell equity or equity-related securities in the future (at a time and price that is deemed appropriate), or to use its stock as consideration for an acquisition. *See Risk Factors - Our Ability to Successfully Conduct Acquisitions Will Affect Our Ability to Grow Our Franchise and Compete Effectively in Our Marketplace*

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

As of December 31, 2007, the net book value of our properties was \$30.7 million. The following is a list of our offices:

Burr Ridge (Executive Office)  
15W060 North Frontage Road  
Burr Ridge, IL 60527

Calumet City  
1901 Sibley Boulevard  
Calumet City, IL 60409

Calumet Park  
1333 W. 127th Street  
Calumet Park, IL 60827

Chicago Hyde Park  
1354 East 55th Street  
Chicago, IL 60615

Chicago Hyde Park East  
55th at Lake Park Avenue  
Chicago, IL 60615

Chicago Ridge  
6415 W. 95th Street  
Chicago Ridge, IL 60415

Chicago-Lincoln Park  
2424 N. Clark Street  
Chicago-Lincoln Park, IL 60614

Deerfield  
630 N. Waukegan Road  
Deerfield, IL 60015

Hazel Crest  
3700 W. 183rd Street  
Hazel Crest, IL 60429

Joliet  
1401 N. Larkin  
Joliet, IL 60435

Lincolnshire  
One Marriott Drive  
Lincolnshire, IL 60069

Lincolnwood  
3443 W. Touhy  
Lincolnwood, IL 60712

Naperville  
1200 East Ogden Avenue  
Naperville, IL 60563

North Libertyville  
1409 W. Peterson Road  
Libertyville, IL 60048

Northbrook  
1368 Shermer Road  
Northbrook, IL 60062

Olympia Fields  
21110 S. Western Avenue  
Olympia Fields, IL 60461

Orland Park  
48 Orland Square Drive  
Orland Park, IL 60462

Schaumburg  
1005 Wise Road  
Schaumburg, IL 60193

South Libertyville  
1123 S. Milwaukee Avenue  
Libertyville, IL 60048

Except for our Chicago-Lincoln Park, Northbrook, and Hyde Park East offices, which are leased, all of our offices are owned.

**ITEM 3. LEGAL PROCEEDINGS**

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

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

During the fourth quarter of the fiscal year covered by this report, the Company did not submit any matters to the vote of security holders.

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

Our shares of common stock are traded on the Nasdaq Global Select Market under the symbol BFIN. The approximate number of holders of record of the Company's common stock as of December 31, 2007 was 2,017. Certain shares of the Company's common stock are held in nominee or street name, and accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number.

The following table presents quarterly market information provided by the Nasdaq Stock Market for the Company's common stock and cash dividends paid for the periods ended December 31, 2007 and 2006.

<b>2006 and 2007 Quarterly Periods</b>	<b>High</b>	<b>Low</b>	<b>Close</b>	<b>Cash Dividends Paid</b>
Quarter ended December 31, 2007	\$ 16.67	\$ 14.54	\$ 15.82	\$ 0.07
Quarter ended September 30, 2007	16.39	13.01	15.82	0.07
Quarter ended June 30, 2007	16.75	15.45	15.45	0.07
Quarter ended March 31, 2007	17.98	16.10	16.27	0.07
Quarter ended December 31, 2006	\$ 18.50	\$ 17.23	\$ 17.81	\$ 0.06
Quarter ended September 30, 2006	18.11	16.31	17.49	0.06
Quarter ended June 30, 2006	17.30	15.15	17.30	0.06
Quarter ended March 31, 2006	16.41	14.55	15.92	

For a discussion of the Bank's ability to pay dividends, see Part I, Item I, Business - Supervision and Regulation - Federal Banking Regulation - Capital Distributions.

**Recent Sales of Unregistered Securities**

The Company had no sales of unregistered stock during the fiscal year ended December 31, 2007.

**Repurchases of Our Equity Securities**

The following table sets forth information in connection with the repurchases of our common stock that were made pursuant to our stock repurchase program during the fourth quarter of 2007:

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number of Shares that May Yet be Purchased under the Plans or Programs (1)</b>
October 1, 2007 through October 31, 2007	51,800	\$ 15.766	51,800	834,261
November 1, 2007 through November 30, 2007	149,100	\$ 15.612	149,100	685,161
December 1, 2007 through December 31, 2007	135,000	\$ 15.645	135,000	550,161
Totals	335,900		335,900	

- (1) Our Board of Directors has authorized the repurchase of up to 3,605,384 shares of our common stock. The current share repurchase authorization will expire on March 31, 2008, unless extended.

**Stock Performance Graph**

*The following Performance Graph and related information shall not be deemed soliciting material or to be filed with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that the Company specifically incorporates it by reference into such filing.*

We completed our mutual-to-stock conversion on June 23, 2005, in connection with which the Company sold an aggregate of 24,466,250 shares of common stock at a price of \$10.00 per share. The Company's common stock began trading on the Nasdaq Stock Market under the symbol BFIN on June 24, 2005, and the per share closing price of one share of the Company's common stock on that date was \$13.60. The following graph represents \$100 invested in our common stock at the \$13.60 per share closing price on June 24, 2005. The graph illustrates the comparison of the cumulative total returns for the common stock of the Company, the Russell 2000 Index, the NASDAQ Bank Index and the America's Community Bankers NASDAQ Index for the periods indicated.

There can be no assurance that our stock performance will continue in the future with the same or similar trend depicted in the graph below. We will not make or endorse any predictions as to future stock performance.

	<b>6/24/2005</b>	<b>12/31/2005</b>	<b>12/31/2006</b>	<b>12/31/2007</b>
BankFinancial Corporation	100.00	107.94	132.34	119.67
Russell 2000 Index	100.00	107.49	127.24	125.24
NASDAQ Bank Index	100.00	102.59	113.88	88.74
America's Community Bankers NASDAQ Index	100.00	103.69	114.92	86.43

**ITEM 6. SELECTED FINANCIAL DATA**

The following information is derived from the audited consolidated financial statements of the Company or, prior to June 24, 2005, BankFinancial MHC, Inc. For additional information, reference is made to Management's Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements of the Company and related notes included elsewhere in this Annual Report.

	2007	2006	At December 31, 2005		2004	2003
			(Dollars in thousands)			
<b>Selected Financial Condition Data:</b>						
Total assets	\$ 1,480,544	\$ 1,613,298	\$ 1,614,436	\$ 1,492,782	\$ 1,457,911	
Loans, net	1,253,999	1,330,091	1,231,891	1,091,952	1,067,248	
Loans held-for-sale	173	298	375	5,531	5,280	
Securities available-for-sale at fair value	77,049	117,853	248,238	268,093	257,520	
Goodwill	22,566	22,579	10,865	10,865	10,865	
Core deposit intangible	7,769	9,648	8,248	9,882	11,583	
Deposits	1,073,650	1,129,585	1,067,874	1,115,696	1,073,897	
Borrowings	96,433	138,148	191,388	264,742	268,225	
Equity	291,137	326,015	328,777	94,888	96,687	
	2007	2006	Years Ended December 31, 2005		2004	2003
			(Dollars in thousands, except per share data)			
<b>Selected Operating Data:</b>						
Interest and dividend income	\$ 91,953	\$ 94,086	\$ 80,212	\$ 66,738	\$ 68,686	
Interest expense	38,304	37,489	28,802	23,470	30,552	
Net interest income	53,649	56,597	51,410	43,268	38,134	
Provision (credit) for loan losses	697	(136)	518	(22)	(579)	
Net interest income after provision (credit) for loan losses	52,952	56,733	50,892	43,290	38,713	
Noninterest income	9,648	10,509	8,665	8,618	8,355	
Noninterest expense (1)	52,482	52,370	44,206	50,715	64,061	
Income (loss) before income tax expense	10,118	14,872	15,351	1,193	(16,993)	
Income tax expense (benefit)	2,963	4,826	4,278	(264)	(7,415)	
Net income (loss)	\$ 7,155	\$ 10,046	\$ 11,073	\$ 1,457	\$ (9,578)	
Basic earnings per common share	\$ 0.35	\$ 0.45	\$ 0.29	N.A.	N.A.	
Diluted earnings per common share	\$ 0.35	\$ 0.45	\$ 0.29	N.A.	N.A.	

N.A. Not applicable

(footnotes on following page)



	At or For the Years Ended December 31,				
	2007	2006	2005	2004	2003
<b>Selected Financial Ratios and Other Data:</b>					
<b>Performance Ratios:</b>					
Return on assets (ratio of net income (loss) to average total assets)	0.47%	0.61%	0.70%	0.10%	(0.66%)
Return on equity (ratio of net income (loss) to average equity)	2.30	3.02	5.18	1.54	(9.98)
Net interest rate spread (2)	2.94	2.89	3.04	2.96	2.50
Net interest margin (3)	3.78	3.68	3.44	3.14	2.77
Efficiency ratio (4)	82.91	78.04	73.58	97.74	137.80
Noninterest expense to average total assets	3.42	3.19	2.79	3.46	4.39
Average interest-earning assets to average interest-bearing liabilities	130.95	132.67	120.45	110.49	111.72
Dividends declared per share	\$ 0.28	\$ 0.18	\$	N.A.	N.A.
Dividend payout ratio	90.6%	44.3%		N.A.	N.A.
<b>Asset Quality Ratios:</b>					
Nonperforming assets to total assets	0.87%	0.57%	0.36%	0.44%	0.60%
Nonperforming loans to total loans	0.95	0.69	0.46	0.59	0.66
Allowance for loan losses to nonperforming loans	91.65	115.13	201.19	168.90	169.02
Allowance for loan losses to total loans	0.87	0.79	0.93	1.00	1.12
Net charge-offs (recoveries) to average loans outstanding	0.02	0.07	0.00	0.09	(0.01)
<b>Capital Ratios:</b>					
Equity to total assets at end of period	19.66%	20.21%	20.36%	6.36%	6.63%
Average equity to average assets	20.32	20.25	13.48	6.45	6.58
Tier 1 leverage ratio (bank only)	13.95	15.05	13.82	7.12	7.18
<b>Other Data:</b>					
Number of full service offices	18	18	16	16	16
Employees (full time equivalents)	425	438	451	446	482

- (1) Noninterest expense for the year ended December 31, 2004 includes \$8.8 million of impairment loss on securities available-for-sale. Noninterest expense for the year ended December 31, 2003 includes \$8.3 million of prepayment penalties related to the restructuring of Federal Home Loan Bank advances and \$12.5 million of impairment loss on securities available-for-sale.
- (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.

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

The discussion and analysis that follows focuses on the factors affecting our consolidated financial condition at December 31, 2007 and 2006, and our consolidated results of operations for the years ended December 31, 2007, 2006 and 2005. The consolidated financial statements and related notes and the discussion of our critical accounting policies appearing elsewhere in this Annual Report should be read in conjunction with this discussion and analysis.

**Overview**

**Loans.** Net loans receivable decreased \$76.1 million, or 5.7%, to \$1.254 billion at December 31, 2007, from \$1.330 billion at December 31, 2006, primarily due to planned decreases in construction and land loans and one- to four-family residential mortgage loans. Construction and land loans decreased by \$20.7 million. One- to four-family residential mortgage loans decreased by \$52.3 million, partially due to the securitization of \$23.5 million of conforming adjustable-rate residential mortgage loans with Fannie Mae. Non-residential real estate loans increased by \$5.2 million. Commercial loans decreased by \$6.1 million and commercial leases increased by \$5.7 million. Multi-family real estate loans decreased by \$5.7 million. Future loan growth could be adversely affected by our unwillingness to compete for loans by relaxing our historical underwriting standards.

**Securities Available for Sale.** Securities available for sale decreased \$40.8 million, or 34.6%, to \$77.0 million at December 31, 2007, from \$117.9 million at December 31, 2006. The primary reasons for the decrease were the maturing of \$46.7 million in securities, excluding the activity in the short-term discount notes, and a negative \$12.0 million change in market value principally related to our Freddie Mac preferred stocks. The decrease was partially offset by our securitization of \$23.5 million of conforming adjustable-rate residential mortgage loans with Fannie Mae during the fourth quarter of 2007. We received securities in exchange for the securitized loans, and recorded no gain or loss on the transaction.

**Deposits.** Deposits decreased \$55.9 million, or 5.0%, to \$1.074 billion at December 31, 2007, from \$1.130 billion at December 31, 2006. The decrease was primarily due to a \$19.5 million decrease in wholesale certificates of deposit and a \$37.8 million decrease in retail certificates of deposit.

**Borrowings.** Borrowings decreased \$41.7 million, or 30.2%, to \$96.4 million at December 31, 2007, from \$138.1 million at December 31, 2006, primarily due to our decision to repay \$66.0 million in maturing FHLB of Chicago advances.

**Stockholders' Equity.** Total stockholders' equity totaled \$291.1 million at December 31, 2007, compared to \$326.0 million at December 31, 2006. The decrease in total stockholders' equity was primarily due to our repurchase of 2,077,923 shares of our common stock at an aggregate cost of \$34.0 million, the declaration and payment of cash dividends totaling \$6.5 million, and a \$7.2 million decrease in accumulated other comprehensive income. These changes were partially offset by our 2007 net income of \$7.2 million and a \$5.6 million increase resulting from the vesting of stock based compensation and ESOP shares earned.

**Net Income.** We had net income of \$7.2 million for the year ended December 31, 2007, compared to net income of \$10.0 million in 2006 and \$11.1 million in 2005. Our basic earnings per common share was \$0.35 and \$0.45 for the years ended December 31, 2007 and 2006, respectively. Our basic earnings per share for 2005 was \$0.29, representing basic earnings per share for the partial year beginning on June 23, 2005, the date that we completed our mutual-to-stock conversion, and ending on December 31, 2005.

**Net Interest Income.** Net interest income decreased \$3.0 million to \$53.6 million for the year ended December 31, 2007, from \$56.6 million for the year ended December 31, 2006. Among the principal factors contributing to the decrease in net interest income was a \$4.1 million decrease in interest earned on investment securities available-for-sale due to a \$117.0 million decline in the average investment securities available-for-sale balance. In addition, interest expense increased \$815,000, primarily due to a 31 basis point increase in the average cost of interest-bearing liabilities.

**Provision for Loan Losses.** We recorded a provision for loan losses of \$697,000 for the year ended December 31, 2007, compared to credit for loan losses of \$136,000 for 2006 and a provision for loan losses of \$518,000 for 2005.

**Noninterest Income.** Noninterest income totaled \$9.6 million for the year ended December 31, 2007, compared to \$10.5 million for 2006 and \$8.7 million in 2005. The decrease from 2007 to 2006 was due in part to a \$592,000 decrease in deposit service charges and fees, a \$314,000 decrease in insurance commissions and annuities income and a \$92,000 decrease in title insurance agency commissions and fees. Gains on the sale of securities totaled \$399,000 for the year ended December 31, 2007, compared to \$101,000 in 2006 and no gains or losses on the sale of securities in 2005. There was a \$9,000 gain on the disposition of premises and equipment for the year ended December 31, 2007, compared to gains of \$395,000 and \$21,000 for the years ended December 31, 2006 and 2005, respectively.

**Noninterest Expense.** Noninterest expense for the year ended December 31, 2007 was \$52.5 million, compared to \$52.4 million for 2006 and \$44.2 million for 2005. Compensation and benefits expense for 2007 included \$5.1 million in stock-based compensation expense, compared to \$5.4 million in 2006 and \$718,000 in 2005. In addition, noninterest expense for 2007 included a \$1.2 million pre-tax charge, which reflected our proportionate share of Visa's estimated litigation obligations, compared to no such expense for the years ended December 31, 2006 and 2005.

**Income Taxes.** We recorded income tax expense of \$3.0 million for the year ended December 31, 2007, compared to \$4.8 million for 2006 and \$4.3 million for 2005.

### **Key Strategic Initiatives And Events**

**Stock Repurchase Program.** Our Board of Directors has authorized the repurchase of up to 3,605,384 shares of our common stock. The authorization permits shares to be repurchased in open market or negotiated transactions, and pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission. The authorization may be utilized at management's discretion, subject to the limitations set forth in Rule 10b-18 of the Securities and Exchange Commission and other applicable legal requirements, and to price and other internal limitations established by the Board of Directors. On September 28, 2007 the Board of Directors extended the expiration date of the share repurchase authorization until March 31, 2008. As of December 31, 2007, we had repurchased 3,055,223 shares of common stock at an aggregate cost of \$51.2 million pursuant to this authorization.

**Quarterly Cash Dividends.** Our Board of Directors declared four quarterly cash dividends of \$0.07 per share during 2007. Total cash dividends paid in 2007 were \$6.5 million. On January 31, 2008, the Board of Directors declared a quarterly dividend of \$0.07 per share payable on March 7, 2008.

**Equity Incentive Plan.** On June 27, 2006, our stockholders approved the BankFinancial Corporation 2006 Equity Incentive Plan, which authorized the Human Resources Committee of the Board of Directors to grant a variety of cash-based and equity-based incentive awards, including stock options, stock appreciation rights, restricted stock, performance shares and other incentive awards, to employees and directors aggregating up to 3,425,275 shares of our common stock. In 2006 and 2007, the Human Resources Committee awarded stock options to purchase 1,602,200 shares of our common stock and 833,450 shares of restricted stock to certain employees and directors of the Company. The 2006 Equity Incentive Plan was established by the Board of Directors to promote the long-term financial success of the Company, to attract, retain and reward persons who can and do contribute to such success, and to further align the participants' interests with those of our stockholders.

On February 20, 2008, the Board of Directors approved certain amendments to the 2008 Board compensation program and the 2007 management incentive compensation program based on the recommendation of the Board's Human Resources Committee. The Board determined that, commencing in March of 2008, the fee payable for service on the Board will be paid in the form of stock options instead of cash. The Board increased the value of the board fees by 10% to compensate the Directors for accepting the market risk associated with the stock option awards.

The amendments further provide that participants in the management incentive compensation program, including the Company's Chief Executive Officer, Chief Financial Officer and certain other officers, may elect to receive some or all of the incentive compensation they earned for 2007 in the form of stock options instead of cash. If participants elect to receive stock options, they will receive that number of stock options with a grant date fair value (calculated according to the Company's GAAP expense for the stock options in accordance with Statement of Financial Accounting Standards (SFAS) No. 123R,) equal to the amount of the cash incentive compensation foregone. Participants will receive additional stock options with a grant date fair value equal to 10% of the stock options received in lieu of the cash incentive award to compensate participants for the additional market risk associated with the stock option awards. The stock options granted in lieu of the cash incentive compensation will be fully vested at grant, while 50% of the additional options will vest on December 15, 2008 and the remaining 50% will vest on June 15, 2009.

### **Economic And Competitive Conditions**

Business conditions exhibited increasing uncertainty as 2007 progressed. In general, market conditions were more competitive in 2007, especially with respect to the pricing for new and existing core deposit accounts. Pricing for high-quality loans worsened for most of 2007 but began to improve late in 2007 as capital market conditions deteriorated. The strength of the U.S. economy faltered as the year concluded; in response, the U.S. Treasury curve became more favorable for the Company in 2008.

We experienced modest growth in our combined multifamily/commercial real estate and commercial leasing portfolios. We also experienced stronger growth in our commercial loan portfolio, but our successful resolutions of certain healthcare loans resulted in a net balance reduction for 2007. Our residential and construction portfolios declined during the year consistent with our planning. We expect that the uncertainty surrounding the U.S. economy and certain real estate markets will increase the unpredictability of the volume of our loan originations and loan repayments in 2008.

Our overall loan portfolio quality remained essentially constant during 2007. We encountered isolated situations where multifamily or small commercial real estate borrowers were unable to properly manage their investment property cash flows or had difficulty maintaining occupancy due to neighborhood safety issues. We expect that most cases will be resolved during 2008 with little or no negative financial consequences for the Company.

Our construction loan portfolio quality remained stable as we reduced the portfolio balances significantly during 2007. We are closely monitoring the capability of certain borrowers to continue making debt service payments on their construction projects. We expect that there will be isolated cases where we elect not to renew certain construction loans and pursue either negotiated collateral dispositions or formal legal remedies if the borrower is unable to continue scheduled debt service or proposes unacceptable exit solutions.

As we expected, pursuant to our model, our general loan loss reserves continued to increase due to the changes in national and local economic risk factors. We continue to believe that adherence to our historical loan underwriting standards remains appropriate.

Deposits declined in 2007 due in part to our decision to reduce interest rates on higher-balance money market accounts and certificates of deposit consistent with overall declines in the Prime Rate and U.S. Treasury yields. Competition for deposits from certain institutions increased, however, as competitors maintained constant deposit interest rates on higher-balance checking, savings, money market and certificates of deposit accounts; accordingly, our customer retention activities resulted in balance migration to higher-yielding accounts. We expect the intensity of this competition to moderate to a limited extent in 2008, but this could be offset by the continued pressures from competitors with mortgage- or construction-related liquidity issues or competitors engaged in de novo branch office expansion.

Our net interest margin and net interest spread were relatively stable during the year. Nonetheless, we believe that such behavior may not necessarily continue because of further reductions in our construction and healthcare loan portfolios and continued deposit pricing pressures. These factors could be offset by a more favorable interest rate environment and potentially widening commercial credit spreads on multifamily and commercial real estate loans. In addition, on a comparative basis, other factors affecting net interest margin include the cumulative effects of our share repurchase program and the fact that our 2007 investment in Bank-Owned Life Insurance produces non-

interest income rather than interest income. We expect that these factors will continue to affect our net interest margin in future quarters; however, we are also focused on generating positive influences through the further diversification of our commercial credit portfolio, optimization of the overall mix of the loan portfolio and gathering non-interest bearing deposits from local small businesses.

Non-interest income declined in 2007 due in part to reduced fee income on deposit accounts and a lower volume of insurance-related sales. We believe that deposit fee income could improve modestly but Title Insurance and Wealth Management will not contribute as strongly to earnings in 2008 as in 2007.

Our focus on organizational efficiency resulted in a reduction of core operating expenses in 2007; overall expenses rose due to non-recurring factors involving a \$250,000 fraud loss that we recorded in connection with claims that we settled with the bankruptcy trustee and our blanket bond carrier for defalcations committed by a third party loan servicing company and liabilities arising from our membership in Visa USA. We expect expenses for marketing (especially retail deposits and small business customers), commercial business development personnel and certain technology investments related to customer service and commercial loan operations to increase in 2008, but the increase is expected to be partially offset by continued targeted reductions in staff and expenses consistent with the results of performance reviews and new technology deployments.

### **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 as follows:

**Investment Securities.** The classification and accounting for investment securities are discussed in detail in Note 1 of the Consolidated Financial Statements presented elsewhere herein. Under SFAS No 115, Accounting for Certain Investments in Debt and Equity Securities, investment securities must be classified as held-to maturity, available-for sale, or trading. The appropriate classification is based partially on our ability to hold the securities to maturity and largely on management's intentions with respect to either holding or selling the securities. The classification of investment securities is significant since it directly impacts the accounting for unrealized gains and losses on securities. Unrealized gains and losses on available-for-sale securities are recorded as a separate component of stockholders' equity (accumulated other comprehensive income or loss) and do not affect earnings until realized. The fair values of our investment securities are generally determined by reference to quoted market prices and reliable independent sources. We are obligated to assess, at each reporting date whether there is an other-than-temporary impairment to our investment securities. Such impairment must be recognized in current earnings rather than in other comprehensive income (loss). Investment securities are discussed in more detail in Note 4 to the Consolidated Financial Statements presented elsewhere herein.

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

**Intangible Assets.** Acquisitions accounted for under purchase accounting must follow SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 141 requires us to record as assets on our financial statements both goodwill, an intangible asset which is equal to the excess of the purchase price which we pay for another company over the estimated fair value of the net assets acquired, and identifiable intangible assets such as core deposit intangibles and non-compete agreements. Under SFAS No. 142, we evaluate goodwill at least annually, or when business conditions suggest an impairment may have occurred, for impairment, and we will reduce its carrying value through a charge to earnings if impairment exists. Core deposit and other identifiable intangible assets are amortized to expense over their estimated useful lives and are reviewed for impairment at least annually, or whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. The valuation techniques used by us to determine the carrying value of tangible and intangible assets acquired in acquisitions and the estimated lives of identifiable intangible assets involve estimates for discount rates, projected future cash flows and time period calculations, all of which are susceptible to change based on changes in economic conditions and other factors. Future events or changes in the estimates that we used to determine the carrying value of our goodwill and identifiable intangible assets or which otherwise adversely



affect their value or estimated lives could have a material adverse impact on our results of operations. As of December 31, 2007, our intangible assets consisted of goodwill of \$22.6 million and core deposit intangibles of \$7.8 million.

**Mortgage Servicing Rights.** Mortgage servicing rights represent the present value of the future servicing fees from the right to service loans in our loan servicing portfolio. Mortgage servicing rights are recognized as assets for the allocation value of retained servicing rights on loans sold. The most critical accounting policy associated with mortgage servicing is the methodology used to determine the fair value of capitalized mortgage servicing rights, which requires a number of estimates, the most critical of which is the mortgage loan prepayment speed assumption. The mortgage loan prepayment speed assumption is significantly affected by interest rates. In general, during periods of falling interest rates, mortgage loans prepay faster and the value of our mortgage servicing assets declines. Conversely, during periods of rising rates, the value of mortgage servicing rights generally increases due to slower rates of prepayments. The amount and timing of mortgage servicing rights amortization is adjusted monthly based on actual results. In addition, on a quarterly basis, we perform a valuation review of mortgage servicing rights for potential declines in value. This quarterly valuation review entails applying current assumptions to the portfolio classified by interest rates and, secondarily, by geographic and prepayment characteristics. Based on the significance of any changes in assumptions since the preceding appraisal, this valuation may include an independent appraisal of the fair value of our servicing portfolio.

**Income Taxes.** We consider accounting for income taxes a critical accounting policy due to the subjective nature of certain estimates that are involved in the calculation. We use the asset/liability method of accounting for income taxes in which deferred tax assets and liabilities are established for the temporary differences between the financial reporting basis and the tax basis of our assets and liabilities. We must assess the realization of the deferred tax asset and, to the extent that we believe that recovery is not likely, a valuation allowance is established. Adjustments to increase or decrease the valuation allowance are charged or credited, respectively, to income tax expense. No valuation allowances were required at December 31, 2007. Although we have determined a valuation allowance is not required for any deferred tax assets, there is no guarantee that these assets will be recognizable in the future.

## **Comparison of Financial Condition at December 31, 2007 and December 31, 2006**

### **Balance Sheet**

Total assets decreased \$132.8 million, or 8.2%, to \$1.481 billion at December 31, 2007, from \$1.613 billion at December 31, 2006. The principal reasons for the decrease in total assets were reductions in construction and land loans, one- to four-family residential mortgage loans, and securities.

Our loan portfolio consists primarily of investment and business loans, which make up approximately 72.0% of our gross loans. Net loans receivable decreased \$76.1 million, or 5.7%, to \$1.254 billion at December 31, 2007, from \$1.330 billion at December 31, 2006, primarily due to planned decreases in construction and land loans and one- to four-family residential mortgage loans. Construction and land loans decreased by \$20.7 million, or 24.3%, to \$64.5 million. One- to four-family residential mortgage loans decreased by \$52.3 million, or 13.2%, to \$345.2 million, partially due to the securitization of \$23.5 million of conforming adjustable rate residential mortgage loans with Fannie Mae. Commercial leases increased by \$5.7 million, or 4.1%, to \$144.8 million. Commercial loans decreased by \$6.1 million, or 6.8%, to \$83.2 million. Multi-family real estate loans decreased by \$5.7 million, or 1.9%, to \$291.4 million.

Our allowance for loan losses increased by \$429,000, from \$10.62 million at December 31, 2006 to \$11.05 million at December 31, 2007, due principally to a \$404,000 increase in the portion of the allowance for loan losses that we allocate to impaired loans pursuant to SFAS No. 114 and a \$25,000 net increase in the general loan loss reserves that we establish pursuant to SFAS No. 5, *Accounting for Contingencies*, based on changes to the economic factors utilized in our model. As of December 31, 2007, our SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, allocation for impaired loans totaled \$806,000.

Net securities available-for-sale decreased \$40.8 million, or 34.6%, to \$77.0 million at December 31, 2007, from \$117.9 million at December 31, 2006. The primary reasons for the decrease were the maturing of \$46.7 million in

securities, excluding the activity in the short-term discount notes, and a negative \$12.0 million change in market value principally related to our Freddie Mac preferred stocks. The decrease was partially offset by our securitization of \$23.5 million of conforming adjustable rate residential mortgage loans with Fannie Mae during the fourth quarter of 2007. We received securities in exchange for the securitized loans, and recorded no gain or loss on the transaction.

Cash and cash equivalents decreased by \$38.4 million to \$28.9 million at December 31, 2007, compared to \$67.3 million at December 31, 2006. The decrease was due in part to our purchase of \$19.0 million of Bank-Owned Life Insurance during 2007. Other assets increased by \$6.3 million, or 89.2%, to \$13.3 million at December 31, 2007, from \$7.0 million at December 31, 2006, principally due to an increase in deferred taxes.

Deposits decreased \$55.9 million, or 5.0%, to \$1.074 billion at December 31, 2007, from \$1.130 billion at December 31, 2006. The decrease was primarily due to a \$19.5 million, or 90.7%, decrease in wholesale certificates of deposit and a \$37.8 million, or 11.0%, decrease in retail certificates of deposit. Total core deposits (savings, money market, noninterest bearing demand and NOW accounts) increased slightly as a percentage of total deposits, representing 71.3% of total deposits at December 31, 2007, compared to 69.4% of total deposits at December 31, 2006.

Borrowings decreased \$41.7 million, or 30.2%, to \$96.4 million at December 31, 2007, from \$138.1 million at December 31, 2006, primarily due to our decision to repay \$66.0 million in maturing FHLB of Chicago advances. Overall, FHLB of Chicago advances decreased \$48.5 million, or 37.3%, to \$81.5 million, from \$130.0 million at December 31, 2006.

Total stockholders' equity totaled \$291.1 million at December 31, 2007, compared to \$326.0 million at December 31, 2006. The decrease on total stockholders' equity was primarily due to our repurchase of 2,077,923 shares of our common stock at an aggregate cost of \$34.0 million, the declaration and payment of cash dividends totaling \$6.5 million, and a \$7.2 million decrease in accumulated other comprehensive income due principally to a change in the fair value of our investments in Freddie Mac preferred stock. These changes were partially offset by our 2007 net income of \$7.2 million and a \$5.6 million increase resulting from the vesting of stock based compensation and ESOP shares earned.

#### **Loan Portfolio**

We originate multi-family mortgage loans, nonresidential real estate loans, commercial loans, commercial leases, and construction and land loans. In addition, we originate one- to four-family residential mortgage loans and consumer loans. We also purchase and sell loan participations from time to time. The following briefly describes our principal loan products.

**Multi-family Mortgage Loans.** Loans secured by multi-family mortgages totaled approximately \$291.4 million, or 23.1% of our total loan portfolio at December 31, 2007. Multi-family mortgage loans generally are secured by multi-family rental properties, such as apartment buildings, including subsidized apartment units. The majority of our multi-family mortgage loans have adjustable interest rates following an initial fixed-rate period, typically between three and five years.

**Nonresidential Real Estate Loans.** Loans secured by nonresidential real estate totaled \$325.9 million, or 25.8% of our total loan portfolio at December 31, 2007. We emphasize nonresidential real estate loans with initial principal balances between \$1.0 million and \$5.0 million. The nonresidential real estate properties securing these loans are predominantly office buildings, light industrial buildings, shopping centers and mixed-use developments and, to a lesser extent, more specialized properties such as nursing homes and other healthcare facilities. Substantially all of our nonresidential real estate loans are secured by properties located in our primary market area. Our nonresidential real estate loans are typically written as three- or five-year adjustable-rate mortgage loans or mortgage loans with balloon maturities of three or five years. Amortization of these loans is typically based on 20- to 25-year payout schedules. We also originate some 15-year fixed-rate, fully amortizing loans.

**Commercial Loans.** Commercial loans totaled \$83.2 million, or 6.6% of our total loan portfolio at December 31, 2007. These totals include unsecured commercial loans with an aggregate outstanding balance of \$9.4 million. We



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

**Commercial Leases.** Commercial leases totaled \$144.8 million, or 11.5% of our total loan portfolio at December 31, 2007. Our commercial leases are secured primarily by technology equipment, material handling equipment, and other capital equipment through an assignment of the lease and a security interest in the equipment being leased. Leases generally are non-recourse to the leasing company. Consequently, we underwrite leases by examining the creditworthiness of the lessee rather than the lessor. The lessee acknowledges our security interest in the leased equipment and generally agrees to send lease payments directly to us. Lessees tend to be publicly-traded companies with a public debt rating or companies that have not issued public debt and therefore do not have a public debt rating. As of December 31, 2007, 53.1% of our commercial lease portfolio involved lessees with investment-grade rated debt, 5.5% involved lessees with debt rated below investment-grade, and 41.4% involved lessees with no public debt rating. We require that a maximum of 10% of our commercial lease portfolio can involve lessees with debt rated below investment-grade. Ratings are determined by Moody's, Standard & Poors, Fitch, or AM Best's or an equivalent rating. Commercial leases have a maximum maturity of nine years and a maximum outstanding credit exposure of \$11.4 million to any single entity. Leases to companies without public debt ratings generally involve companies with net worth in excess of \$25.0 million and are subjected to the same internal credit analysis as any other commercial customer. Commercial leases to these lessees have a maximum maturity of seven years and a maximum outstanding credit exposure of \$11.4 million.

**Construction and Land Loans.** Construction and land loans amounted to \$64.5 million, or 5.1% of the total loan portfolio at December 31, 2007. These loans generally consist of land acquisition loans to help finance the purchase of land intended for further development, including single-family houses, multi-family housing and commercial income property, development loans to builders in our market area to finance improvements to real estate, consisting mostly of single-family subdivisions, typically to finance the cost of utilities, roads, sewers and other development costs. Builders generally rely on the sale of single-family homes to repay development loans, although in some cases the improved building lots may be sold to another builder, often in conjunction with development loans. In general, the maximum loan-to-value ratio for a land acquisition loan is 65% of the appraised value of the property, and the maximum term of these loans is two years. The maximum amount loaned on a development loan is generally limited to the cost of the improvements, and advances are made in accordance with a schedule reflecting the cost of the improvements. Advances are generally limited to 90% of actual construction costs and, as required by applicable regulations, a 75% loan to completed appraised value ratio.

**One- to Four-Family Residential Mortgage Lending.** Conforming and non-conforming fixed-rate and adjustable-rate residential mortgage loans totaled \$345.2 million, or 27.3% of our total loan portfolio at December 31, 2007, including home equity loans and lines of credit totaling \$17.2 million, or 1.4% of our total loan portfolio, and \$77.2 million, or 6.1% of our total loan portfolio, respectively. We generally originate both fixed- and adjustable-rate loans in amounts up to the maximum conforming loan limits as established by Fannie Mae, which is currently \$417,000 for single-family homes. Private mortgage insurance is required for first mortgage loans with loan-to-value ratios in excess of 80%. At December 31, 2007, our adjustable-rate residential mortgage loan portfolio totaled \$175.9 million, and included \$71.5 million in loans that reprice once a year and \$104.4 million in loans that reprice periodically after an initial fixed-rate period of three years or more. During 2007 and 2005, we securitized some of our conforming adjustable-rate residential mortgage loans and retained the servicing rights. In addition to traditional one- to four-family residential mortgage loans, we offer home equity loans and home equity lines of credit that are secured by the borrower's primary residence.

We also originate loans above conforming limits, referred to as jumbo loans, that have been underwritten to the credit standards of Fannie Mae. These loans are generally eligible for sale to various firms that specialize in the purchase of such non-conforming loans. In our market, the Chicago metropolitan area, larger residential loans are not uncommon. We also originate loans that do not fully meet the credit standards of Fannie Mae if they are deemed to be acceptable risks given their favorable compensating risk factors. In general, we do not originate or purchase loans with underwriting characteristics that, taken together, are materially lower than the credit standards of Fannie Mae.

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**Loan Portfolio Composition.** The following table sets forth the composition of our loan portfolio, excluding loans held for sale, by type of loan at the dates indicated.

	2007		2006		At December 31, 2005		2004		2003	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
One- to four-family residential	\$ 345,245	27.33%	\$ 397,545	29.71%	\$ 404,196	32.63%	\$ 362,701	32.97%	\$ 350,275	32.54%
Multi-family mortgage	291,395	23.07	297,131	22.20	280,238	22.62	241,713	21.97	240,733	22.36
Nonresidential real estate	325,885	25.80	320,729	23.97	275,418	22.23	277,380	25.22	270,128	25.09
Construction and land	64,483	5.10	85,222	6.37	80,705	6.52	59,369	5.40	64,403	5.98
Commercial loans	83,233	6.59	89,346	6.68	68,988	5.58	63,727	5.79	67,950	6.31
Commercial leases	144,841	11.47	139,164	10.40	121,898	9.84	86,362	7.85	72,962	6.78
Consumer	3,506	0.28	4,045	0.30	2,022	0.16	2,755	0.25	3,502	0.32
Other (1)	4,544	0.36	4,959	0.37	5,219	0.42	6,044	0.55	6,621	0.62
<b>Total loans</b>	<b>1,263,132</b>	<b>100.00%</b>	<b>1,338,141</b>	<b>100.00%</b>	<b>1,238,684</b>	<b>100.00%</b>	<b>1,100,051</b>	<b>100.00%</b>	<b>1,076,574</b>	<b>100.00%</b>
Loans in process	(168)		148		2,180		824		993	
Net deferred loan origination costs	2,086		2,424		2,541		2,096		1,715	
Allowance for loan losses	(11,051)		(10,622)		(11,514)		(11,019)		(12,034)	
<b>Total loans, net</b>	<b>\$ 1,253,999</b>		<b>\$ 1,330,091</b>		<b>\$ 1,231,891</b>		<b>\$ 1,091,952</b>		<b>\$ 1,067,248</b>	

(1) Includes municipal loans.

**Loan Portfolio Maturities**

The following table summarizes the scheduled repayments of our loan portfolio at December 31, 2007. Demand loans, loans having no stated repayment schedule or maturity and overdraft loans are reported as being due in one year or less.

	Within One Year	One Year Through Five Years (Dollars in thousands)	Beyond Five Years	Total
<b>Scheduled Repayments of Loans:</b>				
One- to four-family residential	\$ 40,429	\$ 62,328	\$ 242,488	\$ 345,245
Multi-family mortgage	18,548	97,919	174,928	291,395
Nonresidential real estate	100,565	189,952	35,368	325,885
Construction and land	55,842	8,394	247	64,483
Commercial loans, leases and other	135,510	91,561	5,547	232,618
Consumer	2,346	745	415	3,506
<b>Total loans</b>	<b>\$ 353,240</b>	<b>\$ 450,899</b>	<b>\$ 458,993</b>	<b>\$ 1,263,132</b>
				<b>Total</b>
<b>Loans maturing after one year:</b>				
Predetermined (fixed) interest rates				\$ 463,401
Adjustable interest rates				446,491
<b>Total loans</b>				<b>\$ 909,892</b>

**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 believe that there is sufficient reason to question the borrower's ability to continue to meet contractual principal or interest payment obligations. 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. We may have loans classified as 90 days or more delinquent and still accruing. Generally, the Bank does not utilize this category of loan classification unless: (1) the loan is repaid in full shortly after period end date or; (2) the loan is well secured and there are no asserted or pending legal barriers to its collection or; (3) the borrower has remitted all scheduled payments and is otherwise in substantial compliance with the terms of the loan, but the processing of loan payments actually received or the renewal of the loan has not occurred for administrative reasons. At December 31, 2007 and 2006, we had no loans in this category.

At December 31, 2007, we had nonaccrual loans of \$12.1 million, an increase of \$2.8 million from December 31, 2006. Increases in nonaccrual loans occurred in multifamily real estate loans (\$3.0 million), commercial loans (\$332,000), construction and land loans (\$988,000) and commercial leases (\$65,000). Decreases in nonaccrual loans occurred in nonresidential real estate loans (\$1.6 million) and one- to four-family residential loans (\$16,000). At December 31, 2007, no accrued interest on nonaccrual loans has been recognized. The increase in nonaccrual multifamily loans was due in substantial part to our placing on non-accrual status a \$2.7 million loan that is secured by an apartment building located in a northern Chicago suburb. We placed the loan on non-accrual status because the borrowers used the investment property cash flow to make equity investor distributions rather than to make scheduled loan payments that were due on or before December 31, 2007. We subsequently entered into a forbearance agreement with the borrowers that is expected to restore the loan to accrual status by the end of the first quarter of 2008. The same borrowers have a second loan that is secured by a similarly-situated apartment building that remained on accrual status as of December 31, 2007. At December 31, 2007, the gross non-accrued interest totaled \$470,000.

Real estate acquired as a result of foreclosure or by deed in lieu of foreclosure is classified as real estate owned ( REO ) until such time as 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 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. At December 31, 2007, we had REO consisting of a one- to four- family residential property with a fair value of \$252,000 and two nonresidential real estate properties with a fair value of \$568,000; at December 31, 2006 we had no REO. The following table below sets forth the amounts and categories of our nonperforming loans and nonperforming assets at the dates indicated.

	2007	2006	At December 31, 2005 2004 2003 (Dollars in thousands)		
<b>Nonaccrual loans:</b>					
One- to four-family residential	\$ 2,196	\$ 2,212	\$ 1,484	\$ 1,725	\$ 2,793
Multi-family mortgage	4,186	1,165	477	1,226	
Nonresidential real estate	2,823	4,378	2,464	2,093	3,616
Construction and land	988				345
Commercial loans	1,751	1,419	1,159	1,259	366
Commercial leases	112	47	139	221	
Consumer	2	5			
<b>Total nonperforming loans</b>	<b>12,058</b>	<b>9,226</b>	<b>5,723</b>	<b>6,524</b>	<b>7,120</b>
<b>Real estate owned:</b>					
One- to four-family residential	252		153		749
Nonresidential real estate	568				
Land					885
<b>Total real estate owned</b>	<b>820</b>		<b>153</b>		<b>1,634</b>
<b>Total nonperforming assets</b>	<b>\$ 12,878</b>	<b>\$ 9,226</b>	<b>\$ 5,876</b>	<b>\$ 6,524</b>	<b>\$ 8,754</b>
<b>Ratios:</b>					
Nonperforming loans to total loans	0.95%	0.69%	0.46%	0.59%	0.66%
Nonperforming assets to total assets	0.87	0.57	0.36	0.44	0.60

**Risk Classification of Assets**

Our policies, consistent with regulatory guidelines, provide for the classification of loans and other assets that are considered to be of lesser quality as substandard, doubtful, or loss assets. An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in assets classified substandard with the added characteristic that the weaknesses present also make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets is not warranted.

On the basis of our review of our assets at December 31, 2007, classified assets consisted of substandard assets of \$27.4 million and doubtful assets of \$562,000, and we had no loans classified as loss assets. The classified assets total includes \$8.5 million of nonperforming loans. Included in substandard assets are \$16.7 million of loans to healthcare providers. As of December 31, 2007, we had not taken any charge-offs on loans to healthcare providers, but we established a specific loan loss reserve allowance in the amount of \$259,000 for loans to one healthcare provider with an aggregate principal balance of \$6.3 million. As of December 31, 2007, we had \$9.6 million of assets designated as special mention, which includes \$9.2 million of loans to healthcare providers.

### Allowance for Loan Losses

We establish provisions for loan losses, which are charged to operations in order to maintain the allowance for loan losses at a level we consider necessary to absorb probable incurred credit losses in the loan portfolio. In determining the level of the allowance for loan losses, we consider past and current loss experience, 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 later events change. We assess the allowance for loan losses on a quarterly basis and make provisions for loan losses in order to maintain the allowance.

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

specific allowances established for any impaired multi-family mortgage, nonresidential real estate, construction and land, commercial, and commercial lease loans for which the recorded investment in the loan exceeds the measured value of the loan;

general allowances for loan losses for each loan type based on historical loan loss experience; and adjustments to historical loss experience (general allowances), maintained to cover uncertainties that affect our estimate of probable incurred losses for each loan type.

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

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

We regularly review our loan portfolio to determine whether any loans require classification in accordance with applicable regulations. When we classify loans as either substandard or doubtful, we review the collateral and future cash flow projections to determine if a specific reserve is necessary. The allowance for loan losses represents amounts that have been established to recognize incurred losses in the loan portfolio that are both probable and reasonably estimable at the date of the financial statements. When we classify problem loans as loss, we charge-off such amount. While we use the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the information used in making the evaluations. Our determination as to the risk classification of our loans and the amount of our loss allowances are subject to review by our regulatory agencies, which can require that we establish additional loss allowances.

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

	2007	At or For the Years Ended December 31,			2003
		2006	2005	2004	
		(Dollars in thousands)			
Balance at beginning of year	\$ 10,622	\$ 11,514	\$ 11,019	\$ 12,034	\$ 12,461
Charge-offs:					
One- to four-family residential	(10)				(29)
Multi-family mortgage					
Nonresidential real estate				(1,127)	
Construction and land					
Commercial loans	(237)	(946)	(49)	(218)	(368)
Commercial leases					
Consumer	(58)	(26)	(66)	(48)	(36)
Total charge-offs	(305)	(972)	(115)	(1,393)	(433)
Recoveries:					
One- to four-family residential				68	26
Multi-family mortgage					
Nonresidential real estate					275(1)
Construction and land					
Commercial loans	14		88	311	278
Commercial leases					
Consumer	23	4	4	21	6
Total recoveries	37	4	92	400	585
Net (charge-offs) recoveries	(268)	(968)	(23)	(993)	152
Allowance of acquired bank		212			
Provision (credit) for loan losses	697	(136)	518	(22)	(579)
Balance at end of year	\$ 11,051	\$ 10,622	\$ 11,514	\$ 11,019	\$ 12,034
Ratios:					
Net charge-offs (recoveries) to average loans outstanding	0.02%	0.07%	0.00%	0.09%	(0.01)%
Allowance for loan losses to nonperforming loans	91.65	115.13	201.19	168.90	169.02
Allowance for loan losses to total loans	0.87	0.79	0.93	1.00	1.12

(1) Recoveries relate to loans previously charged off by Success Bancshares.

**Net Charge-offs and Recoveries**

Net charge-offs decreased by \$700,000 to \$268,000 for the year ended December 31, 2007, from \$968,000 for the year ended December 31, 2006. Total charge-offs decreased by \$667,000 to \$305,000 for the year ended December 31, 2007, from \$972,000 for the year ended December 31, 2006. Total recoveries in 2007 increased by \$33,000 to \$37,000, compared to \$4,000 in 2006.

Net charge-offs increased by \$945,000 to \$968,000 for the year ended December 31, 2006, from \$23,000 for the year ended December 31, 2005. Total charge-offs increased by \$857,000 to \$972,000 for the year ended December 31, 2006, from \$115,000 for the year ended December 31, 2005. Total recoveries in 2006 decreased by \$88,000, compared to 2005.

We recorded a provision for loan losses of \$697,000 in 2007, compared to a credit for loan losses of \$136,000 in 2006 and a provision for loan losses of \$518,000 in 2005.



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**Allocation of Allowance for Loan Losses**

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

	2007			At December 31, 2006			2005		
	Allowance for Loan Losses	Loan Balances by Category	Percent of Loans in Each Category to Total Loans	Allowance for Loan Losses	Loan Balances by Category	Percent of Loans in Each Category to Total Loans	Allowance for Loan Losses	Loan Balances by Category	Percent of Loans in Each Category to Total Loans
(Dollars in thousands)									
One- to four-family residential	\$ 1,823	\$ 345,245	27.33%	\$ 1,855	\$ 397,545	29.71%	\$ 1,418	\$ 404,196	32.63%
Multi-family mortgage	2,206	291,395	23.07	1,908	297,131	22.20	2,102	280,238	22.62
Nonresidential real estate	3,055	325,885	25.80	2,846	320,729	23.97	3,423	275,418	22.23
Construction and land	937	64,483	5.10	1,120	85,222	6.37	1,210	80,705	6.52
Commercial loans	1,726	83,233	6.59	1,667	89,346	6.68	2,362	68,988	5.58
Commercial leases	1,174	144,841	11.47	1,112	139,164	10.40	718	121,898	9.84
Consumer	45	3,506	0.28	40	4,045	0.30	17	2,022	0.16
Other (1)	85	4,544	0.36	74	4,959	0.37	104	5,219	0.42
Unallocated							160		
Total	\$ 11,051	\$ 1,263,132	100.00%	\$ 10,622	\$ 1,338,141	100.00%	\$ 11,514	\$ 1,238,684	100.00%

	2004			At December 31, 2003		
	Allowance for Loan Losses	Loan Balances by Category	Percent of Loans in Each Category to Total Loans	Allowance for Loan Losses	Loan Balances by Category	Percent of Loans in Each Category to Total Loans
(Dollars in thousands)						
One- to four-family residential	\$ 1,289	\$ 362,701	32.97%	\$ 1,322	\$ 350,275	32.54%
Multi-family mortgage	1,950	241,713	21.97	1,797	240,733	22.36
Nonresidential real estate	3,304	277,380	25.22	4,313	270,128	25.09
Construction and land	899	59,369	5.40	976	64,403	5.98
Commercial loans	2,736	63,727	5.79	2,908	67,950	6.31
Commercial leases	543	86,362	7.85	365	72,962	6.78
Consumer	18	2,755	0.25	26	3,502	0.32
Other (1)	121	6,044	0.55	166	6,621	0.62
Unallocated	159			161		
Total	\$ 11,019	\$ 1,100,051	100.00%	\$ 12,034	\$ 1,076,574	100.00%



(1) Includes municipal loans.

## Investment Securities

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

At December 31, 2007, our debt securities consisted of mortgage-backed pass-through securities issued or sponsored by Fannie Mae, Freddie Mac or Ginnie Mae, collateralized mortgage obligations ( CMOs ) and real estate mortgage investment conduits ( REMICs ) guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae, SBA guaranteed loan participation certificates, and municipal securities. Our equity securities consisted almost entirely of shares of two floating rate preferred stocks issued by Freddie Mac, a government-sponsored enterprise and one Freddie Mac fixed-rate preferred stock. All securities were classified as available for sale pursuant to SFAS No. 115 as of December 31, 2007, 2006 and 2005.

We hold the FHLBC common stock to qualify for membership in the Federal Home Loan Bank System and to be eligible to borrow funds under the FHLBC s advance program. The aggregate cost and fair value of our FHLBC common stock as of December 31, 2007 was \$15.6 million based on its par value. There is no market for our FHLBC common stock. Due to our receipt of stock dividends and a reduction of our outstanding FHLBC advances, we owned shares of FHLBC common stock at December 31, 2007 with a par value that was \$8.4 million more than we were required to own, to maintain our membership, in the Federal Home Loan Bank System and to be eligible to obtain advances ( excess or voluntary capital stock). During 2006, the FHLBC undertook limited redemptions of excess or voluntary capital stock. We redeemed \$9.6 million of excess or voluntary FHLBC capital stock in 2006.

On October 10, 2007, the FHLBC entered into a consensual cease and desist order with the Federal Housing Finance Board. Under the terms of the order, capital stock repurchases and redemptions, including redemptions upon membership withdrawal or other termination, are prohibited unless the FHLBC receives the prior approval of the Director of the Office of Supervision of the Federal Housing Finance Board (the Director ). The order also provides that dividend declarations are subject to the prior written approval of the Director and that the FHLBC must submit a Capital Structure Plan to the Federal Housing Finance Board. Since that time, the FHLBC has announced that it would not pay a dividend in the fourth quarter of 2007, and that it is engaged in merger discussions with the Federal Home Loan Bank of Dallas but has not yet entered into a merger agreement.

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The following table sets forth the composition, amortized cost and fair value of our securities available for sale at the dates indicated.

	2007		At December 31, 2006		2005	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value (Dollars in thousands)	Amortized Cost	Fair Value
<b>Investment Securities:</b>						
Municipal securities	\$ 2,210	\$ 2,272	\$ 2,660	\$ 2,711	\$ 3,085	\$ 3,145
SBA guaranteed loan participation certificates	595	592	628	623	1,859	1,853
Equity securities:						
Freddie Mac	38,275	31,225	38,275	43,112	65,600	67,375
Fannie Mae					18,360	19,795
Other debt securities			45,746	45,723		
Total investment securities available-for-sale	41,080	34,089	87,309	92,169	88,904	92,168
<b>Mortgage-Backed Securities:</b>						
Pass-through securities:						
Fannie Mae	34,536	34,522	14,506	14,630	146,433	143,098
Freddie Mac	3,633	3,641	3,967	3,971	10,182	10,009
Ginnie Mac	1,138	1,114	1,238	1,202	1,349	1,321
CMOs and REMICs	3,649	3,683	5,841	5,881	1,615	1,642
Total mortgage-backed securities available-for-sale	42,956	42,960	25,552	25,684	159,579	156,070
Total securities available-for-sale	\$ 84,036	\$ 77,049	\$ 112,861	\$ 117,853	\$ 248,483	\$ 248,238

We determine the fair value of our investment securities in accordance with the guidance set forth in SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, and SFAS No. 107, Disclosures about Fair Value of Financial Instruments. Pursuant to this guidance, we determine fair value based on the most recent quoted market price, if available, for the security as of the applicable balance sheet date. If a quoted market price for a specific security is not currently available, we estimate the fair value based on the quoted market price of another security with similar characteristics, adjusted to reflect objectively measurable differences such as coupon rates and reset dates. In the absence of current quoted market prices for the same or a similar security, we use other valuation techniques to determine fair value, such as obtaining broker-dealer valuations or estimating fair value based on valuation modeling. The fair value of a security is used to determine the amount of any unrealized losses that must be reflected in our other comprehensive income and the net book value of our investment securities. Similarly, if we determine that a security is other-than-temporarily impaired under Securities and Exchange Commission Codification of Staff Accounting Bulletins, Topic 5: Miscellaneous Accounting Item M, Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities, we use the fair value of the security to determine the amount of the impairment loss and the adjusted cost basis for the security.

The only securities in our investment portfolio that had significant declines in fair value at December 31, 2007 were our Freddie Mac preferred stocks. The adjusted cost basis for these securities was \$38.3 million at December 31, 2007, and their fair value at that date was \$31.2 million, based on quoted market prices for these securities. The quoted market prices for these securities have been volatile in recent months on generally low trading volumes. We evaluated these securities for impairment at December 31, 2007 and concluded that the declines were primarily attributable to changes in market volatility and market interest rates rather than credit quality or other issuer-specific factors. Since the Company has the ability and intent at December 31, 2007, to hold these investments until a recovery occurs and the carrying cost of these securities is projected to recover as market interest rates change and or the securities approach maturity, the Company did not consider the declines in fair value to be other-than-temporary impairments. A number of factors or combinations of factors could cause us to conclude, in one or more future reporting periods, that an existing unrealized loss constitutes an impairment that is other than temporary with respect to these securities. See *Risk Factors, We Could Record Future Losses on Our Holdings of Freddie Mac Preferred Stock*. No significant unrealized losses existed at December 31, 2006 with respect to our marketable

equity securities, including our Freddie Mac floating rate preferred stocks.

**Portfolio Maturities and Yields.** The composition and maturities of the investment securities portfolio and the mortgage-backed securities portfolio at December 31, 2007 are summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur. Municipal securities yields have not been adjusted to a tax-equivalent basis as the amount is immaterial.

	One Year or Less		More than One Year		More than Five Years		More than Ten Years		Total Securities		Fair Value
	Weighted	Weighted	through Five Years	through Five Years	through Ten Years	through Ten Years	Years	Weighted	Weighted	Average	
	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	
(Dollars in thousands)											
<b>Mortgage-Backed Securities:</b>											
Pass-through securities:											
Fannie Mae	\$	%\$	%\$	1,637	5.21%	\$ 32,899	4.91%	\$ 34,536	4.93%	\$ 34,522	
Freddie Mac	15	6.50	7	6.25	788	6.38	2,823	5.78	3,633	5.93	3,641
Ginnie Mae							1,138	5.06	1,138	5.06	1,114
CMOs and REMICs			951	4.63	56	5.45	2,642	5.33	3,649	5.14	3,683
<b>Total</b>	<b>15</b>	<b>6.50</b>	<b>958</b>	<b>4.64</b>	<b>2,481</b>	<b>5.58</b>	<b>39,502</b>	<b>5.01</b>	<b>42,956</b>	<b>5.03</b>	<b>42,960</b>
<b>Investment Securities:</b>											
Municipal securities	475	4.20	1,385	4.37	350	4.53			2,210	4.36	2,272
SBA guaranteed loan participation certificates					126	5.75	469	5.46	595	5.52	592
Equity securities							38,275	4.98	38,275	4.98	31,225
<b>Total</b>	<b>475</b>	<b>4.20</b>	<b>1,385</b>	<b>4.37</b>	<b>476</b>	<b>4.47</b>	<b>38,744</b>	<b>4.98</b>	<b>41,080</b>	<b>4.95</b>	<b>34,089</b>
<b>Total securities available-for-sale</b>	<b>\$ 490</b>	<b>4.27%</b>	<b>\$ 2,343</b>	<b>4.48%</b>	<b>\$ 2,957</b>	<b>5.46%</b>	<b>\$ 78,246</b>	<b>5.00%</b>	<b>\$ 84,036</b>	<b>4.99%</b>	<b>\$ 77,049</b>

**Sources of Funds**

**Deposits.** At December 31, 2007, our deposits totaled \$1.074 billion. Interest-bearing deposits totaled \$962.1 million and noninterest-bearing demand deposits totaled \$111.6 million. NOW, savings and money market deposits totaled \$654.5 million at December 31, 2007. Demand deposits at December 31, 2007 included \$5.0 million in internal checking accounts, such as bank cashier checks and money orders and \$3.5 million in title insurance escrow funds. At December 31, 2007, we had a total of \$307.6 million in certificates of deposit, of which \$269.5 million had maturities of one year or less. Although we have a significant portion of our deposits in shorter-term certificates of deposit, we monitor activity on these accounts and, based on historical experience and our current pricing strategy, we believe we will retain a significant portion of these accounts upon maturity.

Our deposits are obtained predominantly from the areas in which our branch offices are located. We rely on our favorable locations, customer service, competitive pricing, our Internet Branch and related deposit services such as cash management to attract and retain these deposits. While we accept certificates of deposit in excess of \$100,000 for which we may provide preferential rates, we generally do not solicit such deposits because they are more difficult to retain than core deposits. At December 31, 2007, we had a total of \$2.0 million of brokered certificates of deposits.

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

	2007		Years Ended December 31, 2006			2005		Weighted Average Rate
	Average Balance	Percent	Average Balance	Percent	Average Balance	Percent		
			(Dollars in thousands)					
Demand deposits:								
Retail	\$ 29,936	2.74%	% \$ 33,020	3.00%	% \$ 23,512	2.10%		%
Commercial	86,620	7.91	90,594	8.24	85,435	7.62		
Total demand deposits	116,556	10.65	123,614	11.24	108,947	9.72		
NOW deposits	282,670	25.82	241,378	21.95	268,404	23.93	0.85	
Savings deposits	106,870	9.76	123,413	11.22	128,867	11.49	0.78	
Money market deposits	260,256	23.77	252,109	22.93	223,334	19.92	2.84	
Certificates of deposit	328,371	30.00	359,119	32.66	391,883	34.94	2.79	
Total deposits	\$ 1,094,723	100.00%	\$ 1,099,633	100.00%	\$ 1,121,435	100.00%		

The following table sets forth certificates of deposit by time remaining until maturity at December 31, 2007.

	Maturity				Total
	3 Months or Less	Over 3 to 6 Months	Over 6 to 12 Months	Over 12 Months	
	(Dollars in thousands)				
Certificates of deposit less than \$100,000	\$ 74,950	\$ 60,013	\$ 70,670	\$ 32,381	\$ 238,014
Certificates of deposit of \$100,000 or more	26,088	22,502	15,229	5,784	69,603
Total of certificates of deposit	\$ 101,038	\$ 82,515	\$ 85,899	\$ 38,165	\$ 307,617

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

	At or For the Years Ended December 31,		
	2007	2006	2005
	(Dollars in thousands)		
Balance at end of year	\$ 96,433	\$ 138,148	\$ 191,388
Average balance during year	104,782	183,286	229,355
Maximum outstanding at any month end	139,366	241,048	274,311
Weighted average interest rate at end of year	4.71%	4.30%	3.72%
Average interest rate during year	4.64%	4.11%	3.58%

At December 31, 2007, we had the ability to borrow an additional \$206.9 million under our credit facilities with the FHLBC. Furthermore, we had unpledged securities that could be used to support borrowings in excess of \$25.0 million.

At December 31, 2007, we had available pre-approved overnight federal funds borrowing capacity of \$65.0 million. At December 31, 2007, there were no outstanding federal funds borrowings. At December 31, 2007, we also had a line of credit available with the Federal Reserve Bank of Chicago for \$3.1 million. At December 31, 2007, there was no outstanding balance on the line of credit.

### Comparison of Operating Results For the Years Ended December 31, 2007, 2006 and 2005

#### Net Income

**Comparison of Year 2007 to 2006.** We recorded net income of \$7.2 million for the year ended December 31, 2007, compared to net income of \$10.0 million for the year ended December 31, 2006. The principal factors affecting the change in net income from year to year included a \$2.9 million, or 5.2%, decrease in our net interest income; an \$833,000 increase in our provision for loan losses, a \$861,000, or 8.2%, decrease in noninterest income, and a \$112,000, or 0.2%, increase in noninterest expense; These reductions to income were offset by a \$1.9 million, or 38.6%, decrease in income tax expense. Our operating results for 2007 were unfavorably impacted by a pre-tax charge of \$1.2 million, which reflected our proportionate share of Visa's estimated litigation obligations. The charge was recorded because the Bank, like other Visa USA members, is obligated to share expenses resulting from certain Visa litigation, proportionately with its ownership interests in Visa USA. If Visa USA's initial public offering is completed as planned, our proportionate share of the proceeds of the initial offering is expected to offset or exceed the amount of this charge. Our operating results for 2007 also included \$5.1 million in expenses for equity-based compensation and benefits, compared to \$5.4 million for 2006. Our earnings per share of common stock for year ended December 31, 2007 was \$0.35 per share. Earnings per share for the year ended December 31, 2006 was \$0.45.

**Comparison of Year 2006 to 2005.** We recorded net income of \$10.0 million for the year ended December 31, 2006, compared to net income of \$11.1 million for the year ended December 31, 2005. The principal factors affecting the change in net income from year to year included a \$5.2 million, or 10.1%, increase in our net interest income; a \$1.8 million, or 21.3%, increase in noninterest income; and a \$654,000 decrease in our provision for loan losses. These increases were offset by an \$8.2 million, or 18.5%, increase in noninterest expense; and a \$548,000, or 12.8%, increase in income tax expense. Our net income for the full year 2006 and for the last six months of 2005 was favorably affected by the completion of our mutual-to-stock conversion on June 23, 2005, and reflected increased interest income and reduced interest expense on borrowings resulting from our deployment of the net proceeds from the subscription offering undertaken in connection with the mutual-to-stock conversion, which totaled \$220.7 million (excluding the \$19.6 million in stock purchased by our ESOP), to increase average interest-earning assets and reduce average borrowings and wholesale deposits. Our operating results for 2006 included \$5.4 million in expenses for equity-based compensation and benefits, compared to \$717,000 for 2005, relating to equity-based awards that were made during the third and fourth quarters of 2006 pursuant to the Equity Incentive Plan that

our stockholders approved in June of 2006, and additional expenses arising from our first full year of making contributions to the ESOP that we established in connection with our mutual-to-stock conversion in June of 2005. Our 2005 net income was also negatively affected by a \$388,000 yield adjustment amortization expense, pre-tax, relating to our restructuring of \$170.0 million of Federal Home Loan Bank borrowings in July 2003. There was no remaining yield adjustment amortization expense recorded during 2006. Our earnings per share of common stock for year ended December 31, 2006 was \$0.45 per share. Earnings per share for the year ended December 31, 2005 was \$0.29 and only includes the net income for the period for which common shares were outstanding which was from the completion of our mutual-to-stock conversion on June 23, 2005 through December 31, 2005.

### Net Interest Income

**Comparison of Year 2007 to 2006.** Net interest income decreased by \$2.9 million, or 5.2%, to \$53.6 million for the year ended December 31, 2007, from \$56.6 million for the year ended December 31, 2006. Our net interest rate spread increased by five basis points to 2.94% for the year ended December 31, 2007, from 2.89% for the year ended December 31, 2006. Our net interest margin increased by 10 basis points to 3.78% for the year ended December 31, 2007, from 3.68% for the year ended December 31, 2006. Our average interest-earning assets decreased \$119.9 million to \$1.418 billion in 2007, from \$1.538 billion in 2006, and our average interest-bearing liabilities decreased \$76.4 million to \$1.083 billion in 2007, from \$1.159 billion in 2006.

Interest income decreased by \$2.1 million, or 2.3%, to \$92.0 million for the year ended December 31, 2007, from \$94.1 million for the year ended December 31, 2006. The decrease in interest income resulted primarily from a \$119.9 million decrease in total average interest-earning assets to \$1.418 billion for the year ended December 31, 2007, from \$1.538 billion for the year ended December 31, 2006. This decrease in total average interest-earning assets was partially offset by a 36 basis point increase in the average yield on interest earning assets to 6.48% for the year ended December 31, 2007, from 6.12% for the year ended December 31, 2006.

Interest income on loans increased by \$2.1 million, or 2.5%, to \$85.6 million for the year ended December 31, 2007, from \$83.5 million for the year ended December 31, 2006. The increase in interest income on loans resulted primarily from a 17 basis point increase in the average yield on loans to 6.60% for the year ended December 31, 2007, from 6.43% for the year ended December 31, 2006, due to higher market interest rates. The increase in the average yield on loans was partially offset by a \$2.3 million, or 0.2%, decrease in the average balance of loans outstanding to \$1.297 billion for the year ended December 31, 2007, from \$1.300 billion for the year ended December 31, 2006.

Interest income on securities available-for-sale decreased \$4.1 million, or 44.9%, to \$5.1 million for the year ended December 31, 2007, from \$9.2 million for the year ended December 31, 2006. The decrease resulted primarily from a planned \$117.0 million decrease, or 57.4%, in the average balance of securities available-for-sale to \$86.9 million for the year ended December 31, 2007, from \$203.9 million for the year ended December 31, 2006, based on our determination in the latter half of 2006 that the flat or inverted yield curve environment did not present profitable opportunities for carrying such additional investments.

Dividend income on our FHLBC common stock decreased \$365,000, or 50.4%, to \$359,000 for the year ended December 31, 2007, from \$724,000 for the year ended December 31, 2006. The average balance of these securities decreased by \$6.2 million to \$15.6 million for the year ended December 31, 2007, due to the redemption of \$9.8 million of these securities in 2006. The FHLBC did not pay any dividends in the fourth quarter of 2007. As a result, the average annual dividend yield on our FHLBC common stock decreased to 2.30% for the year ended December 31, 2007, from 3.32% for the year ended December 31, 2006.

Interest income on interest-bearing deposits in other financial institutions increased \$261,000, or 38.6%, to \$937,000 for the year ended December 31, 2007, from \$676,000 for the year ended December 31, 2006. The average balance of these interest-bearing deposits increased by \$5.5 million to \$18.2 million for the year ended December 31, 2007. The average yield on our interest-bearing deposits decreased to 5.14% for the year ended December 31, 2007, from 5.32% for the year ended December 31, 2006.



Interest expense increased by \$815,000, or 2.2%, to \$38.3 million for the year ended December 31, 2007, from \$37.5 million for the year ended December 31, 2006. The increase was due to increased interest expense on deposits, which was partially offset by decreased interest expense on borrowings.

Interest expense on deposits increased by \$3.5 million, or 11.6%, to \$33.4 million for the year ended December 31, 2007, from \$30.0 million for the year ended December 31, 2006. The increase in interest expense on deposits was primarily due to a 35 basis point increase in the average rates paid on deposits, and a \$2.1 million, or 0.2%, net increase in the average balance of deposits. The average balances of money market deposits increased \$8.1 million, or 3.2%, and NOW deposits increased \$41.3 million, or 17.1%, for the year ended December 31, 2007, respectively. The average balances of savings accounts decreased \$16.5 million, or 13.4%, and the average balances of certificates of deposit decreased \$30.7 million, or 8.6%, respectively, for the year ended December 31, 2007. The average balance of wholesale certificates of deposit decreased \$18.8 million, or 67.1%, due to our decision to reduce these types of deposits. The average cost of deposits was 3.42% for the year ended December 31, 2007, compared to 3.07% for the year ended December 31, 2006. The average rate on savings accounts decreased five basis points to 0.78% from 0.83%, but all other categories of interest-bearing deposit accounts showed increases in average rates paid for 2007 compared to 2006. On a year over year basis, the average cost of money market accounts increased 25 basis points to 4.25%, from 4.00%, the average cost of NOW accounts increased 71 basis points to 2.42%, from 1.71%, and the average cost of certificates of deposit increased 38 basis points to 4.48%, from 4.10%.

Interest expense on borrowings decreased by \$2.7 million, or 35.5%, to \$4.9 million for the year ended December 31, 2007, from \$7.5 million for the year ended December 31, 2006. This decrease was due in principal part to a \$78.5 million, or 42.8%, decrease in the average balance of borrowings resulting from our decision to repay \$66.0 million in maturing FHLB of Chicago advances. This decrease in the average balance of borrowings was partially offset by a 53 basis point increase in the average cost of such borrowings to 4.64% for the year ended December 31, 2007, from 4.11% for the year ended December 31, 2006.

**Comparison of Year 2006 to 2005.** Net interest income increased by \$5.2 million, or 10.1%, to \$56.6 million for the year ended December 31, 2006, from \$51.4 million for the year ended December 31, 2005. Our net interest rate spread decreased by 15 basis points to 2.89% for the year ended December 31, 2006, from 3.04% for 2005. The decrease resulted primarily from the flattening and inverting of the yield curve that has occurred, and increasing competition in the Chicago banking market for loans and deposits. Notwithstanding these market conditions and the resulting decrease in our net interest rate spread, our net interest margin increased by 24 basis points to 3.68% for 2006, from 3.44% for 2005, due to our deployment of the \$220.7 million in net proceeds of our subscription offering to retire term debt and reduce borrowings and wholesale deposits, and our replacement of a significant portion of the short-term securities and interest-bearing deposits in which the offering proceeds were initially invested with higher yielding loans. As expected, our acquisition of University National Bank on April 5, 2006, helped to mitigate the adverse impact that these market conditions had on our net interest margin. In addition, our average interest earning assets increased \$42.2 million to \$1.538 billion in 2006, from \$1.496 billion in 2005, and our average interest-bearing liabilities decreased \$82.5 million to \$1.159 billion in 2006, from \$1.242 billion in 2005, principally as a result of our deployment of the net proceeds of our subscription offering. Our net interest income for the year ended December 31, 2005, included approximately \$450,000 in net interest spread that we earned on the investment of approximately \$167.1 million in subscription order receipts that we subsequently refunded to depositors whose subscription orders could not be filled.

Interest income increased by \$13.9 million, or 17.3%, to \$94.1 million for the year ended December 31, 2006, from \$80.2 million for the year ended December 31, 2005. The increase in interest income resulted primarily from a 76 basis point increase in the average yield on interest earning assets to 6.12% for the year ended December 31, 2006, from 5.36% for the year ended December 31, 2005, and from a \$42.2 million increase in total average interest-earning assets to \$1.538 billion for the year ended December 31, 2006, from \$1.496 billion for the year ended December 31, 2005.

Interest income on loans increased by \$16.9 million, or 25.3%, to \$83.5 million for the year ended December 31, 2006, from \$66.6 million for the year ended December 31, 2005. The increase in interest income on loans resulted primarily from a 54 basis point increase in the average yield on loans to 6.43% for the year ended December 31, 2006, from 5.89% for the year ended December 31, 2005, due to higher market interest rates, and from a \$168.2

million, or 14.9%, increase in the average balance of loans outstanding to \$1.300 billion for the year ended December 31, 2006, from \$1.131 billion for the year ended December 31, 2005.

Interest income on securities available-for-sale decreased \$2.4 million, or 21.1%, to \$9.2 million for the year ended December 31, 2006, from \$11.6 million for the year ended December 31, 2005. The decrease resulted primarily from a decrease of \$111.5 million, or 35.3%, in the average balance of securities available-for-sale to \$203.9 million for the year ended December 31, 2006, from \$315.4 million for the year ended December 31, 2005. This decrease in average balances since 2005 reflected the impact of holding and investing approximately \$436.8 million of subscription order receipts in short-term government agency securities until the subscription offering was completed on June 23, 2005. Thereafter, funds representing accepted subscription orders were paid to the Company, and funds due the subscribers for unfilled subscription orders were refunded. By the end of the third quarter of 2005, substantially all of the subscription order refunds had been paid. We also decided to reduce our portfolio of investment securities available-for-sale during 2006 as the flat or inverted yield curve did not present profitable opportunities for carrying such additional investments. Partially offsetting the decrease in average balances was an 81 basis point increase in the yield on securities available-for-sale to 4.50% for the year ended December 31, 2006, from 3.69% for the year ended December 31, 2005, due to increases in the coupon rates for certain securities.

Dividend income on our FHLBC stock decreased \$484,000, or 40.1%, to \$724,000 for the year ended December 31, 2006, from \$1.2 million for the year ended December 31, 2005. The average balance of these securities decreased by \$3.1 million to \$21.8 million for the year ended December 31, 2006, due to the redemption of \$9.8 million of these securities in 2006. The FHLBC also reduced its dividend rate from 5.5% as of the first quarter of 2005 to 3.10% as of the fourth quarter of 2006. As a result, the average dividend yield on our FHLBC stock decreased to 3.32% for the year ended December 31, 2006, from 4.86% for the year ended December 31, 2005.

Interest income on interest-bearing deposit accounts that we owned decreased \$70,000, or 9.4%, to \$676,000 for the year ended December 31, 2006, from \$746,000 for the year ended December 31, 2005. The average balance of these interest-bearing deposits decreased by \$11.5 million to \$12.7 million for the year ended December 31, 2006. The average yield on our interest-bearing deposits increased to 5.32% for the year ended December 31, 2006, from 3.08% for the year ended December 31, 2005.

Interest expense increased by \$8.7 million, or 30.2%, to \$37.5 million for the year ended December 31, 2006, from \$28.8 million for the year ended December 31, 2005. The increase was primarily due to increased interest expense on deposits, which was partially offset by decreased interest expense on borrowings.

Interest expense on deposits increased by \$9.4 million, or 45.4%, to \$30.0 million for the year ended December 31, 2006, from \$20.6 million for the year ended December 31, 2005. The increase in interest expense on deposits was primarily due to a 104 basis point increase in the average rates paid on deposits, which was partially offset by a \$36.5 million, or 3.6%, decrease in the average balance of deposits. The average balances of money market deposits increased \$28.8 million, or 12.9% for the year ended December 31, 2006. The average balances of savings accounts, NOW deposits and certificates of deposit decreased \$5.5 million, or 4.2%, \$27.0 million, or 10.1%, and \$32.8 million, or 8.4%, respectively, for the year ended December 31, 2006. The average cost of deposits was 3.07% for the year ended December 31, 2006, compared to 2.03% for the year ended December 31, 2005. All categories of interest-bearing deposit accounts showed increases in average rates paid for 2006 compared to 2005. The average cost of certificates of deposits increased 131 basis points to 4.10% for the year ended December 31, 2006, from 2.79% for the year ended December 31, 2005. The average cost of all other interest-bearing deposit accounts also increased for the year ended December 31, 2006, with the most significant increase occurring with respect to money market accounts. The average cost of money market accounts increased 116 basis points to 4.00% for the year ended December 31, 2006, from 2.84% for the year ended December 31, 2005.

Interest expense on borrowings decreased by \$672,000, or 8.2%, to \$7.5 million for the year ended December 31, 2006, from \$8.2 million for the year ended December 31, 2005. This decrease was due in part to a \$46.1 million, or 20.1%, decrease in the average balance of borrowings, which was offset by a 53 basis point increase in the average cost of such borrowings to 4.11% for the year ended December 31, 2006, from 3.58% for the year ended December 31, 2005. The decrease in average borrowings is due in part to our use of a portion of the net proceeds of the sale of investment securities to repay wholesale borrowings. Interest expense for the year ended December 31, 2005 also included \$388,000 in yield adjustment amortization expense relating to the prepayment penalty that we incurred in

restructuring our Federal Home Loan Bank borrowings in July of 2003, while there was no yield adjustment expense recorded in 2006 in connection with the restructuring as final amortization was completed in 2005.

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The following table sets forth average balance sheets, average yields and costs, and certain other information for the periods indicated. 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 were 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 and Federal Home Loan Bank advance prepayment penalties that are amortized or accreted to interest income or expense.

	2007		Years Ended December 31, 2006			2005			
	Average Outstanding Balance	Interest	Yield/Rate	Average Outstanding Balance	Interest	Yield/Rate	Average Outstanding Balance	Interest	Yield/Rate
(Dollars in thousands)									
<b>Interest-earning assets:</b>									
Loans	\$ 1,297,299	\$ 85,601	6.60%	\$ 1,299,597	\$ 83,502	6.43%	\$ 1,131,374	\$ 66,618	5.89%
Securities available-for-sale	86,946	5,056	5.82	203,900	9,184	4.50	315,379	11,640	3.69
Stock in FHLB	15,598	359	2.30	21,813	724	3.32	24,870	1,208	4.86
Other	18,245	937	5.14	12,713	676	5.32	24,219	746	3.08
Total interest-earning assets	1,418,088	91,953	6.48	1,538,023	94,086	6.12	1,495,842	80,212	5.36
Noninterest-earning assets	114,668			102,220			88,837		
Total assets	\$ 1,532,756			\$ 1,640,243			\$ 1,584,679		
<b>Interest-bearing liabilities:</b>									
Savings deposits	\$ 106,870	833	0.78	\$ 123,413	1,019	0.83	\$ 128,867	1,005	0.78
Money market deposits	260,256	11,072	4.25	252,109	10,096	4.00	223,334	6,350	2.84
NOW deposits	282,670	6,837	2.42	241,378	4,128	1.71	268,404	2,290	0.85
Certificates of deposit	328,371	14,704	4.48	359,119	14,714	4.10	391,883	10,953	2.79
Total deposits	978,167	33,446	3.42	976,019	29,957	3.07	1,012,488	20,598	2.03
Borrowings	104,782	4,858	4.64	183,286	7,532	4.11	229,355	8,204	3.58
Total interest-bearing liabilities	1,082,949	38,304	3.54	1,159,305	37,489	3.23	1,241,843	28,802	2.32
Noninterest-bearing deposits	116,556			123,614			108,947		
Noninterest-bearing liabilities	21,831			25,110			20,257		
Total liabilities	1,221,336			1,308,029			1,371,047		
Equity	311,420			332,214			213,632		
Total liabilities and equity	\$ 1,532,756			\$ 1,640,243			\$ 1,584,679		
Net interest income		\$ 53,649			\$ 56,597			\$ 51,410	
			2.94%			2.89%			3.04%

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Net interest rate spread (1)			
Net interest-earning assets (2)	\$ 335,139	\$ 378,718	\$ 253,999
Net interest margin (3)		3.78%	3.68%
Ratio of interest-earning assets to interest-bearing liabilities	130.95%	132.67%	120.45%
			3.44%

- (1) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.
- (2) Net interest-earning assets represents total interest-earning assets less total interest-bearing liabilities.
- (3) Net interest margin represents net interest income divided by average total interest-earning assets.

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

	Years Ended December 31,					
	2007 vs. 2006			2006 vs. 2005		
	Increase (Decrease) Due to Volume	Increase (Decrease) Due to Rate	Total Increase (Decrease)	Increase (Decrease) Due to Volume	Increase (Decrease) Due to Rate	Total Increase (Decrease)
<b>Interest-earning assets:</b>						
Loans	\$ (148)	\$ 2,247	\$ 2,099	\$ 10,465	\$ 6,419	\$ 16,884
Securities available-for-sale	(6,285)	2,157	(4,128)	(4,673)	2,217	(2,456)
Stock in FHLB	(176)	(189)	(365)	(135)	(349)	(484)
Other	285	(24)	261	(456)	386	(70)
<b>Total interest-earning assets</b>	<b>(6,324)</b>	<b>4,191</b>	<b>(2,133)</b>	<b>5,201</b>	<b>8,673</b>	<b>13,874</b>
<b>Interest-bearing liabilities:</b>						
Savings deposits	(131)	(55)	(186)	(44)	58	14
Money market deposits	333	643	976	898	2,848	3,746
NOW deposits	792	1,917	2,709	(252)	2,090	1,838
Certificates of deposit	(1,316)	1,306	(10)	(981)	4,742	3,761
Borrowings	(3,544)	870	(2,674)	(1,789)	1,117	(672)
<b>Total interest-bearing liabilities</b>	<b>(3,866)</b>	<b>4,681</b>	<b>815</b>	<b>(2,168)</b>	<b>10,855</b>	<b>8,687</b>
<b>Change in net interest income</b>	<b>\$ (2,458)</b>	<b>\$ (490)</b>	<b>\$ (2,948)</b>	<b>\$ 7,369</b>	<b>\$ (2,182)</b>	<b>\$ 5,187</b>

#### 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 later 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.

**Comparison of Year 2007 to 2006.** We recorded a provision for loan losses of \$697,000 for the year ended December 31, 2007, compared to a credit for loan losses of \$136,000 for the year ended December 31, 2006. The provision for loan losses recorded for 2007 reflected increased specific reserves against certain loans, and a \$25,000 net increase in the general loan loss reserves that we establish pursuant to SFAS No. 5 based on changes to the economic factors utilized in our model. The portion of the allowance for loan losses that we allocate to impaired loans pursuant to SFAS No. 114 increased \$404,000 to \$806,000 at December 31, 2007, from \$402,000 at December 31, 2006. We increased specific reserves primarily due to our receipt of current appraisals reflecting decreases in the value of certain real estate collateral, combined with ongoing business continuity concerns on several commercial credits. Net loan charge-offs for 2007 were \$268,000, or 0.02% of average loans, compared to \$968,000, or 0.07% of average loans, in 2006.

Nonperforming loans increased by \$2.8 million to \$12.1 million at December 31, 2007, from \$9.2 million at December 31, 2006. The increase was due in substantial part to our placing on non-accrual status a \$2.7 million loan that is secured by an apartment building located in a northern Chicago suburb. We placed the loan on non-accrual status because the borrowers used the investment property cash flow to make equity investor distributions rather than to make scheduled loan payments that were due on or before December 31, 2007. We subsequently entered into a forbearance agreement with the borrowers that is expected to restore the loan to accrual status by the end of the first quarter of 2008. The same borrowers have a second loan that is secured by a similarly-situated apartment building that remained on accrual status as of December 31, 2007. Our allowance for loan losses was \$11.1 million, or 0.87% of total loans, at December 31, 2007, compared to \$10.6 million, or 0.79% of total loans, at December 31, 2006. The allowance for loan losses represented 91.65% of nonperforming loans at December 31, 2007, and 115.13% of nonperforming loans at December 31, 2006. To the best of our knowledge, we have recorded all losses that are both probable and reasonable to estimate for each reporting period.

**Comparison of Year 2006 to 2005.** We recorded a credit for loan losses of \$136,000 for the year ended December 31, 2006, compared to a provision for loan losses of \$518,000 for the year ended December 31, 2005. The credit for loan losses recorded for 2006 reflected lower specific reserves against certain loans due to higher collateral levels, and offset by net growth in total loans of \$99.3 million during 2006. The portion of the allowance for loan losses that we allocate to impaired loans pursuant to SFAS No. 114 decreased \$1.4 million to \$402,000 at December 31, 2006 from \$1.8 million at December 31, 2005. Recoveries of \$576,000 specific reserves were primarily due to our receipt of current appraisals reflecting increases in the value of certain non-residential real estate securing loans to two health care borrowers. The loans to these borrowers are also partially secured by additional collateral, including home equity and other personal assets, and in the case of one of the borrowers, by marketable securities. Fluctuations in the specific reserves attributable to loans to these borrowers should be expected to occur in the future due to possible changes in the market value of the collateral, and any declines in their market value could result in future provisions for additional specific reserves. Of the \$1.4 million decrease in reserves allocated pursuant to SFAS No. 114, we charged off \$836,000, which included a \$693,000 charge-off of a fully reserved commercial loan due to the conclusion of legal proceedings. We acquired this loan in our acquisition of Success Bancshares in 2001 and have been maintaining specific reserves against it since we closed that acquisition. Net loan charge-offs for 2006 were \$968,000, or 0.07% of average loans compared to \$23,000, or 0.00% of average loans, in 2005. Nonperforming loans increased by \$3.5 million to \$9.2 million at December 31, 2006, from \$5.7 million at December 31, 2005. The allowance for loan losses was \$10.6 million, or 0.79% of total loans, at December 31, 2006, compared to \$11.5 million, or 0.93% of total loans, at December 31, 2005. The allowance for loan losses represented 115.13% of nonperforming loans at December 31, 2006, and 201.19% of nonperforming loans at December 31, 2005. To the best of our knowledge, we have recorded all losses that are both probable and reasonable to estimate for each reporting period.

#### Noninterest Income

	Years Ended December 31,			Percent Change	
	2007	2006	2005	2007/2006	2006/2005
	(Dollars in thousands)				
<b>Noninterest income:</b>					
Deposit fees and service charges	\$ 3,606	\$ 4,198	\$ 3,888	(14.1)%	8.0%
Other fee income	1,939	1,916	1,852	1.2	3.5
Insurance commissions and annuities income	1,007	1,321	848	(23.8)	55.8
Gain on sale of loans	126	246	206	(48.8)	19.4
Gain on sales of securities	399	101		295.0	N.M.
Gain on disposition of premises and equipment	9	395	21	(97.7)	N.M.
Loan servicing fees	811	938	1,031	(13.5)	(9.0)
Amortization and impairment of servicing assets	(396)	(448)	(508)	(11.6)	11.8
Operations of real estate owned	(17)	(45)	4	(62.2)	N.M.
Earnings on Bank Owned Life Insurance (BOLI)	585			N.M.	
Other	1,579	1,887	1,323	(16.3)	42.6
<b>Total noninterest income</b>	<b>\$ 9,648</b>	<b>\$ 10,509</b>	<b>\$ 8,665</b>	<b>(8.2)</b>	<b>21.3</b>

N.M. = not meaningful

**Comparison of Year 2007 to 2006.** Our noninterest income decreased by \$861,000 to \$9.6 million for the year ended December 31, 2007, from \$10.5 million for the year ended December 31, 2006. We experienced a \$592,000, or 14.1%, decrease in deposit service charges and fees to \$3.6 million, and a \$23,000, or 1.2%, increase in other fee income to \$1.9 million. Returned check and non-sufficient funds charges decreased \$401,000 in 2007, from \$3.5 million in 2006, compared to \$3.1 million in 2007. The decrease can be partially attributed to a \$7.1 million decrease in the average balance of non-interest bearing deposits. Income from insurance commissions and annuities decreased by \$314,000, or 23.8%, to \$1.0 million for the year ended December 31, 2007, compared to \$1.3 million for 2006. Gains on sales of loans decreased by \$120,000, or 48.8%, to \$126,000 for 2007, from \$246,000 for 2006, primarily because of lower loan sale volumes in 2007. We recorded a \$399,000 gain on the redemption of MasterCard Class B common stock in 2007, compared to a \$55,000 gain on the same common stock in 2006. We recorded no net gains on the sale of investment securities during 2007, compared to \$46,000 in gains in 2006. We recognized \$9,000 in net gains on the disposition of premises and equipment during 2007, compared to \$395,000 in 2006. Loan servicing fees decreased \$127,000, or 13.5%, to \$811,000 for the year ended December 31, 2007, from \$938,000 for 2006. Mortgage servicing rights amortization expense decreased \$52,000, or 11.6%, to \$396,000 for the year ended December 31, 2007, compared to \$448,000 for the same period in 2006. Net expenses from real estate owned totaled \$17,000 for the year ended December 31, 2007, compared to \$45,000 in 2006. Non-interest income for 2007 included \$585,000 in earnings on Bank-Owned Life Insurance that we purchased in June 2007, compared to no such earnings in 2006. Other income decreased \$308,000, or 16.3%, to \$1.6 million for the year ended December 31, 2007, from \$1.9 million for 2006, partially attributable to a \$92,000 net decrease in title insurance agency commissions and fees earned by Financial Title Services, a division of our subsidiary, Financial Assurance Services.

**Comparison of Year 2006 to 2005.** Our noninterest income increased by \$1.8 million to \$10.5 million for the year ended December 31, 2006, from \$8.7 million for the year ended December 31, 2005. Noninterest income for the year ended December 31, 2006 included approximately \$400,000 in noninterest income relating to the operations of the two former University National Bank facilities. We experienced a \$310,000, or 8.0%, increase in deposit service charges and fees to \$4.2 million, and a \$64,000, or 3.5%, increase in other fee income to \$1.9 million, of which \$218,000 and \$77,000, respectively, related to those two facilities. Income from insurance commissions and annuities increased by \$473,000, or 55.8%, to \$1.3 million for the year ended December 31, 2006, compared to \$848,000 for 2005, due to increased activity resulting from the availability of higher market interest rates on fixed annuities and successful sales initiatives. Gains on sales of loans increased by \$40,000, or 19.4%, to \$246,000 for 2006, from \$206,000 for 2005, primarily because of higher loan sale volumes. We recorded a \$55,000 gain on the redemption of MasterCard Class B common stock and \$46,000 in net gains on the sale of investment securities during 2006, while there were no such gains in 2005. We recognized \$395,000 in net gains on the disposition of premises and equipment during 2006 compared to \$21,000 recognized in 2005. Loan servicing fees decreased \$93,000, or 9.0%, to \$938,000 for the year ended December 31, 2006, from \$1.0 million for 2005. Mortgage servicing rights amortization expense decreased \$177,000, or 26.0% to \$506,000 for the year ended December 31, 2006, compared to \$683,000 for the same period in 2005. We recorded a mortgage servicing rights valuation reserve recovery of \$58,000 for the year ended December 31, 2006, compared to a recovery of \$175,000 for the same period in 2005. Net expenses from real estate owned totaled \$45,000 for the year ended December 31, 2006, compared to net revenues of \$4,000 for the same period in 2005. Other income increased \$564,000, or 42.6%, to \$1.9 million for the year ended December 31, 2006, from \$1.3 million for 2005, due in part to \$106,000 in fees that we recorded in connection with the sale of surplus real estate, a recovery of \$42,000 in connection with a prior fraud loss, and a \$395,000, or 40.6%, net increase in title insurance agency commissions and fees earned by Financial Title Services, a division of our subsidiary, Financial Assurance Services.



**Noninterest Expense**

	Years Ended December 31,			Percent Change	
	2007	2006	2005	2007/2006	2006/2005
	(Dollars in thousands)				
<b>Noninterest Expense:</b>					
Compensation and benefits	\$ 32,276	\$ 34,454	\$ 28,227	(6.3)%	22.1%
Office occupancy and equipment	5,949	5,602	5,058	6.2	10.8
Advertising and public relations	1,412	1,193	841	18.4	41.9
Information technology	3,241	3,341	2,967	(3.0)	12.6
Supplies, telephone and postage	2,109	2,100	1,901	0.4	10.5
Amortization of intangibles	1,879	1,873	1,634	0.3	14.6
Visa litigation	1,240			N.M.	
Other	4,376	3,807	3,578	14.9	6.4
Total noninterest expense	\$ 52,482	\$ 52,370	\$ 44,206	0.2	18.5

N.M. = not meaningful

**Comparison of Year 2007 to 2006.** For the year ended December 31, 2007, noninterest expense increased by \$112,000, or 0.2%, to \$52.5 million, from \$52.4 million for the year ended December 31, 2006. Compensation expense decreased by \$2.2 million, or 6.3%, to \$32.3 million for the year ended December 31, 2007, from \$34.5 million for the year ended December 31, 2006. The decrease can be partially attributed to a decrease of 29 average full time equivalent employees ( FTE ) from 450 FTE in 2006 to 421 FTE in 2007. Expense relating to equity-based compensation and benefits was \$5.1 million in 2007, compared to \$5.4 million during 2006. Information technology expenses decreased by \$100,000, or 3.0%, to \$3.2 million for 2007, compared to \$3.3 million for 2006. Occupancy and equipment increased \$347,000, or 6.2%, to \$5.9 million for 2007 compared to \$5.6 million for 2006, primarily due to a \$94,000 increase in rental expense and the write-off of \$91,000 in feasibility and design costs related to a possible remodeling project and repair work performed at several branches. Advertising and public relations expenses increased \$219,000, or 18.4% to \$1.4 million. Supplies, telephone and postage expenses increased \$9,000, or 0.4%, to \$2.1 million, and intangible amortization expense increased by \$6,000. Our noninterest expense for 2007 included a charge of \$1.2 million, which reflected our proportionate share of Visa's estimated litigation obligations. The charge was recorded because the Bank, like other Visa USA members, is obligated to share expenses, resulting from certain indemnified Visa litigation, proportionately with its ownership interests in Visa USA. If Visa USA's initial public offering is completed as planned, our proportionate share of the proceeds of the initial offering is expected to offset or exceed the amount of this charge. Other expenses increased by \$569,000, or 14.9%, in 2007, and the increase included a \$250,000 fraud loss that we recorded in connection with claims that we settled with the bankruptcy trustee and our blanket bond carrier for defalcations committed by a third party loan servicing company.

**Comparison of Year 2006 to 2005.** For the year ended December 31, 2006, noninterest expense increased by \$8.2 million, or 18.5%, to \$52.4 million, from \$44.2 million for the year ended December 31, 2005. The operations of the two former University National Bank facilities contributed approximately \$1.4 million to this increase in noninterest expense. Compensation expense increased by \$6.3 million, or 22.1%, to \$34.5 million for the year ended December 31, 2006, from \$28.2 million for the year ended December 31, 2005. Expense relating to equity-based compensation and benefits was \$5.4 million in 2006, compared to \$717,000 during 2005, primarily due to equity-based awards that were made pursuant to our Equity Incentive Plan and additional expenses arising from our first full year of making contributions to our ESOP. In addition, \$925,000 of compensation expense related to general merit increases, staff additions and incentive programs, \$319,000 represented increased non-ESOP employee benefit costs, including health care expenses, payroll taxes and 401(k) plan expenses, and approximately \$496,000 of increased compensation and commission-related expense at Financial Assurance and its division, Financial Title Services, partially due to higher levels of insurance, annuity and title insurance agency activities. Except for merit increases, we generally target base compensation increases to compare to the consumer price index. Information technology expenses increased by \$374,000, or 12.6%, to \$3.3 million for 2006, compared to \$3.0 million for 2005, primarily due to approximately \$132,000 related to our need to maintain a separate core banking data processing system for the two former University National Bank facilities pending the completion of the conversion of that system into our core banking data processing system in the third quarter of 2006 and for expenses paid to an outside consultant for a Sarbanes-Oxley compliant internal controls review, including the design and implementation of enhancements to our corporate performance management and reporting systems. Occupancy and



equipment increased \$544,000, or 10.8%, to \$5.6 million for 2006 compared to \$5.1 million for 2005 primarily due to a \$185,000 expense for feasibility and design costs related to a possible reconstruction of an existing branch office, to increased maintenance expenses, real estate taxes and energy costs and to the operation of the two former University National Bank facilities. Advertising and public relations expenses increased \$352,000, or 41.9% to \$1.2 million. Of this amount, approximately \$40,000 related to our first Annual Meeting of Stockholders in June of 2006, including the preparation and mailing of proxy materials and our annual report to our stockholders, proxy solicitation and other annual meeting expenses, and approximately \$52,000 of this increase related to our acquisition of University National Bank. The remainder of the increase in advertising and public relations was principally due to a cross-media campaign to increase retail and small business deposit relationships at targeted branches. Supplies, telephone and postage expenses increased \$199,000, or 10.5%, to \$2.1 million. Our acquisition of University National Bank resulted in the recording of a core deposit intangible of \$3.3 million, and increased our intangible amortization expense by \$239,000 for the year ended December 31, 2006. Other expenses increased by \$229,000, or 6.4%, due a \$97,000 adjustment to franchise taxes payable to the State of Illinois due to the extent to which our mutual-to-stock conversion increased our paid-in capital, and to higher insurance, legal and accounting and auditing costs.

### **Income Tax Expense**

**Comparison of Year 2007 to 2006.** For the year ended December 31, 2007, we recorded income tax expense of \$3.0 million, compared to \$4.8 million for the year ended December 31, 2006. The effective tax rate for 2007 was 29.3% compared to 32.5% in 2006. Items that cause the effective tax rate to be less than the statutory tax rate include the dividends received deduction on preferred stock dividends received, income earned on Bank-Owned Life Insurance and interest income on municipal bonds and municipal loans, respectively.

**Comparison of Year 2006 to 2005.** For the year ended December 31, 2006, we recorded income tax expense of \$4.8 million, compared to \$4.3 million for the year ended December 31, 2005. The income tax expense for 2005 reflects \$500,000 in tax benefits relating to prior years, the majority of which relates to tax returns for which the applicable statute of limitations expired during the third quarter of 2005. The effective tax rate for 2006 was 32.5% compared to 27.9% in 2005.

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

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

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

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

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

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

We actively evaluate interest rate risk in connection with our lending, investing and deposit activities. In an effort to better manage interest-rate risk, we have increased our focus on the origination of adjustable-rate residential mortgage loans, as well as the origination of nonresidential mortgage loans, adjustable rate construction loans and commercial loans. 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 US Treasury yield curve as of the balance sheet date. In addition, we apply consistent parallel yield curve shifts (in both directions) to determine possible changes in net interest income if the theoretical yield curve shifts occurred instantaneously. Net interest income analysis also adjusts the dynamic GAP repricing analysis based on changes in prepayment rates resulting from the parallel yield curve shifts.

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

**Quantitative Analysis.** The following table sets forth, as of December 31, 2007, 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)	NPV			Net Interest Income		
	Estimated NPV	Estimated Increase (Decrease) in NPV		Estimated Net Interest Income	Increase (Decrease) in Net Interest Income	
		Amount	Percent		Amount	Percent
+300	\$ 273,259	\$ (13,466)	(4.70)%	\$ 43,061	\$ (6,080)	(12.37)%
+200	278,053	(8,671)	(3.02)	45,350	(3,791)	(7.71)
+100	282,271	(4,454)	(1.55)	47,329	(1,812)	(3.69)
0	286,724			49,141		
-100	288,120	1,396	0.49	50,945	1,804	3.67
-200	287,653	929	0.32	52,341	3,200	6.51
-300	284,741	(1,983)	(0.69)	52,917	3,776	7.68

The table set forth above indicates that at December 31, 2007, in the event of an immediate 200 basis point decrease in interest rates, the Bank would be expected to experience a 0.32% increase in NPV and a \$3.2 million 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 3.02% decrease in NPV and a \$3.8 million decrease in net interest income. This data does not reflect any actions that we may undertake in response to changes in interest rates, such as changes in rates paid on certain deposit accounts based on local competitive factors, which could reduce the actual impact on NPV and net interest income, if any.

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

## Liquidity Management

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

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

Our cash flows are derived from operating activities, investing activities and financing activities as reported in the Consolidated Statements of Cash Flows in our Consolidated Financial Statements. Our primary investing activities are the origination for investment or sale of one- to four-family residential mortgage loans, the origination for investment of multi-family mortgage, nonresidential real estate, commercial leases, construction, commercial and other loans, and the purchase of investment securities and mortgage-backed securities. During the years ended December 31, 2007, 2006 and 2005, our loans originated for sale totaled \$26.6 million, \$23.9 million and \$20.8 million, respectively. During the years ended December 31, 2007, 2006 and 2005, our loans originated for investment totaled \$752.8 million, \$659.9 million and \$493.5 million, respectively. Purchases of loans totaled \$3.9

million, \$34.5 million and \$113.9 million for the years ended December 31, 2007, 2006 and 2005, respectively. Purchases of securities available-for-sale totaled \$1.446 billion, \$95.1 million and \$10.657 billion for the years ended December 31, 2007, 2006 and 2005, respectively. The significantly high level of purchases in 2007 and 2005 reflects the impact of investing in short-term discounts notes.

These activities were funded primarily by principal repayments on loans and securities, and the sale of loans and securities. During the years ended December 31, 2007, 2006 and 2005, principal repayments on loans totaled \$807.7 million, \$614.6 million and \$442.5 million, respectively. During the years ended December 31, 2007, 2006 and 2005, principal repayments on securities available-for-sale totaled \$5.9 million, \$30.0 million and \$45.8 million, respectively. During the years ended December 31, 2007, 2006 and 2005, proceeds from maturities on securities available-for-sale totaled \$1.492 billion, \$51.8 million and \$10.657 billion, respectively. During the years ended December 31, 2007, 2006 and 2005, the proceeds from the sale of loans totaled \$26.9 million, \$24.7 million and \$26.1 million, respectively. In addition, during the years ended December 31, 2007 and 2005 we securitized \$23.4 million and \$24.2 million of conforming adjustable-rate residential mortgage loans, respectively. During the year ended December 31, 2006, the proceeds from the sale of securities available-for-sale totaled \$230.0 million and from the redemption of Federal Home Loan Bank of Chicago stock totaled \$9.8 million.

Loan origination commitments totaled \$17.6 million at December 31, 2007, and consisted of \$13.6 million of fixed-rate loans and \$4.0 million of adjustable-rate loans. Unused lines of credit and standby letters of credit granted to customers were \$218.8 million and \$4.1 million, respectively, at December 31, 2007. At December 31, 2007, commitments to sell mortgages totaled \$2.8 million.

Deposit flows are generally affected by the level of market interest rates, the interest rates and other conditions on deposit products offered by our banking competitors, and other factors. We had net deposit outflows of \$56.0 million, \$41.8 million, and \$47.8 million for the years ended December 31, 2007, 2006 and 2005, respectively. At times during recent periods, we have not actively competed for higher cost deposit accounts, including certificates of deposit, choosing instead to fund loan growth from the repayment of one- to four-family residential mortgage loans. With the completion of our subscription offering during June of 2005, we specifically allowed the level of wholesale certificates of deposit to decline as we deployed these proceeds over the short term. Certificates of deposit that are scheduled to mature in one year or less from December 31, 2007 totaled \$269.5 million. Based upon prior experience and our current pricing strategy, we believe that a significant portion of these deposits will remain with us.

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 reinvested with us. We generally remain fully invested and utilize additional sources of funds through FHLBC advances, of which \$81.5 million were outstanding at December 31, 2007. At December 31, 2007 we had the ability to borrow an additional \$206.9 million under our credit facilities with the FHLBC. Furthermore, we have unpledged securities that could be used to support borrowings in excess of \$25.0 million. Finally, at December 31, 2007 we had available pre-approved overnight federal funds borrowing lines of \$65.0 million and a line of credit available with the Federal Reserve Bank of Chicago of \$3.1 million. At December 31, 2007, there was no outstanding balance on these credit lines.

We minimize the funds required to originate one- to four-family residential mortgage loans in two ways. We sell in the secondary market virtually all of our eligible fixed-rate one- to four-family residential mortgage loans. From time to time, we also securitize the conforming adjustable-rate one- to four-family residential mortgage loans that we originate and hold the securities we receive in exchange. During 2007, we securitized \$23.5 million of such loans. The resulting mortgage-backed securities that we retain on our balance sheet can be sold more readily to meet our liquidity or interest rate management needs. Because the securities carry a lower risk-weight than the underlying loans, the securitizations also lower our regulatory capital requirements.

**Liquidity Management Company.** The liquidity needs of the Company on an unconsolidated basis consist primarily of operating expenses, dividends to stockholders and stock repurchases. The primary sources of liquidity for the Company currently are \$44.2 million of cash and cash equivalents and periodic cash dividends from the Bank.

During 2007, there were \$47.5 million of dividends paid to the Company by the Bank. Under the rules of the OTS, the Bank is not permitted to pay dividends on its capital stock to the Company, its sole stockholder, if the dividend would reduce the Bank's stockholder's equity below the amount of the liquidation account established in connection with the mutual-to-stock conversion. The Bank may pay dividends without the approval of the OTS so long as the Bank meets its applicable regulatory capital requirements before and after the payment of the dividends and its total dividends do not exceed its net income to date over the calendar year plus retained net income over the preceding two years. The OTS has discretion to prohibit permissible capital distributions on general safety and soundness grounds and must be given 30 days advance notice of all capital distributions from the Bank to the Company, including dividends. At January 1, 2008, the Bank had the ability to pay dividends of \$2.0 million to the Company without the prior approval of the OTS.

During 2007, we used \$34.0 million to repurchase shares of our common stock and paid \$6.5 million in cash dividends to stockholders funded by existing cash and cash equivalents held by the Company.

As of December 31, 2007, we were not aware of any known trends, events or uncertainties that have or are reasonably likely to have a material impact on our liquidity. As of December 31, 2007, we had no other material commitments for capital expenditures.

### Capital Management

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

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

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

At year-end, actual capital ratios and minimum required ratios for the Bank were:

	Actual Ratio	Minimum Required for Capital Adequacy Purposes	Minimum Required to Be Well Capitalized Under Prompt Corrective Action Provisions
<b>December 31, 2007</b>			
Total capital (to risk-weighted assets)	16.54%	8.00%	10.00%
Tier 1 (core) capital (to risk-weighted assets)	15.74	4.00	6.00
Tier 1 (core) capital (to adjusted total assets)	13.95	4.00	5.00
<b>December 31, 2006</b>			
Total capital (to risk-weighted assets)	20.09%	8.00%	10.00%
Tier 1 (core) capital (to risk-weighted assets)	19.26	4.00	6.00
Tier 1 (core) capital (to adjusted total assets)	15.05	4.00	5.00

See Note 14 Regulatory Matters in our Consolidated Financial Statements for a reconciliation of regulatory capital.

As of December 31, 2007 and 2006, the Office of Thrift Supervision 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 category.

**Capital Management Company.** On June 23, 2005, the Company completed its mutual-to-stock conversion and sold 24,466,250 shares of common stock in a subscription offering at \$10.00 per share and raised \$240.3 million (net of offering expenses). The Company contributed \$120.9 million of the net proceeds to the Bank, paid off \$30 million of term debt, loaned \$19.6 million to our ESOP and retained the remaining proceeds of approximately \$72 million. As a result of this offering, the Company has capital levels substantially above that required to support the current size and risk profile of the Company and its subsidiary, the Bank.

Total stockholders' equity totaled \$291.1 million at December 31, 2007, compared to \$326.0 million at December 31, 2006. The decrease on total stockholders' equity was primarily due to our repurchase of 2,077,923 shares of our common stock at an aggregate cost of \$34.0 million, the declaration and payment of cash dividends totaling \$6.5 million, and a \$7.2 million decrease in accumulated other comprehensive income. These changes were partially offset by our 2007 net income of \$7.2 million and a \$5.6 million increase resulting from the vesting of stock-based compensation and ESOP shares earned.

The OTS has no specific quantitative capital regulations for savings and loan holding companies on either a consolidated or unconsolidated basis to which the Company must comply. There are several capital measurements that the OTS uses to evaluate the adequacy of a savings and loan holding company's capital. One measurement is the tangible capital ratio. The tangible capital ratio (the ratio of tangible capital to tangible total assets (stockholders' equity less goodwill and intangible assets divided by total assets less goodwill and intangible assets)) for the Company on a consolidated basis measures the percentage of consolidated tangible equity capital supporting our consolidated tangible total assets. The tangible equity ratio was 17.95% at December 31, 2007, compared to 18.58% at December 31, 2006.

As stated in our Prospectus dated April 15, 2005, our strategy for utilizing the capital raised in the offering encompasses several components, including debt reduction, funding our ESOP, financing acquisitions, paying dividends to stockholders, repurchasing shares of our common stock and for other general corporate purposes.

Our Board of Directors has authorized the repurchase of up to 3,605,384 shares of the Company's common stock. The authorization permits shares to be repurchased in open market or negotiated transactions, and pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission. The authorization may be utilized at management's discretion, subject to the limitations set forth in Rule 10b-18 of the Securities and Exchange Commission and other applicable legal requirements, such as price and other internal limitations established by the Company's Board of Directors. On September 28, 2007 the Board of Directors again extended the expiration date of the Company's share repurchase authorization until March 31, 2008. As of December 31, 2007, we had repurchased 3,055,223 shares of common stock at an aggregate cost of \$51.2 million under this authorization. For additional information, see Part II. Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities. Repurchases of Our Equity Securities.

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

**Commitments.** As a financial services provider, we routinely are a party to various financial instruments with off-balance-sheet risks, such as commitments to extend credit, standby letters of credit, unused lines of credit and commitments to sell loans. While these contractual obligations represent our future cash requirements, a significant portion of commitments to extend credit may expire without being drawn upon. Such commitments are subject to the same credit policies and approval process accorded to loans made by us. Although we consider commitments to



extend credit in determining our allowance for loan losses, at December 31, 2007, we had made no provision for losses on commitments to extend credit, and had no specific or general allowance for losses on such commitments, as we have had no historical loss experience with commitments to extend credit and we believed that no probable and reasonably estimable losses were inherent in our portfolio as a result of our commitments to extend credit. For additional information, see Note 15, Loan Commitments and Other Related Activities, to our Consolidated Financial Statements.

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

The following table summarizes our significant fixed and determinable contractual obligations and other funding needs by payment date at December 31, 2007. The payment amounts represent those amounts due to the recipient and do not include any unamortized premiums or discounts or other similar carrying amount adjustments.

Contractual Obligations	Payments Due by Period				Total
	Less than One Year	One to Three Years	Three to Five Years	More than Five Years	
	(Dollars in thousands)				
Certificates of deposit	\$ 269,452	\$ 37,174	\$ 991	\$	\$ 307,617
Borrowings	59,433	37,000			96,433
Standby letters of credit	3,719	381	40		4,140
Operating leases	573	743	703	7,583	9,602
<b>Total</b>	<b>\$ 333,177</b>	<b>\$ 75,298</b>	<b>\$ 1,734</b>	<b>\$ 7,583</b>	<b>\$ 417,792</b>
Commitments to extend credit	\$ 236,428	\$	\$	\$	\$ 236,428

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

For information regarding market risk see Item 7- Management's Discussion and Analysis of Financial Conditions and Results of Operation Management of Interest Rate Risk.

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

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REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

Management assessed the Company's internal control over financial reporting as of December 31, 2007, as required by Section 404 of the Sarbanes-Oxley Act of 2002, based on the criteria for effective internal control over financial reporting described in the Internal Control-Integrated Framework, adopted by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management concludes that, as of December 31, 2007, the Company's internal control over financial reporting is effective.

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

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

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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have audited the accompanying statements of financial condition of BankFinancial Corporation (the Company) as of December 31, 2007 and 2006, and the related statements of income, changes in stockholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2007. We also have audited the Company's internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

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

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

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BankFinancial Corporation as of December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*.

Crowe Chizek and Company LLC

Oak Brook, Illinois

March 8, 2008

**BANKFINANCIAL CORPORATION****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

December 31, 2007 and 2006

(In thousands, except share and per share data)

	December 31, 2007	December 31, 2006
<b>ASSETS</b>		
Cash and due from other financial institutions	\$ 28,279	\$ 38,286
Interest-bearing deposits in other financial institutions	669	29,051
Cash and cash equivalents	28,948	67,337
Securities available-for-sale, at fair value	77,049	117,853
Loans held-for-sale	173	298
Loans receivable, net of allowance for loan losses: December 31, 2007, \$11,051; and December 31, 2006, \$10,622	1,253,999	1,330,091
Stock in Federal Home Loan Bank, at cost	15,598	15,598
Premises and equipment, net	34,487	35,005
Accrued interest receivable	7,090	7,869
Goodwill	22,566	22,579
Core deposit intangible	7,769	9,648
Bank Owned Life Insurance	19,585	
Other assets	13,280	7,020
Total assets	\$ 1,480,544	\$ 1,613,298
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Liabilities</b>		
Deposits	1,073,650	1,129,585
Borrowings	96,433	138,148
Advance payments by borrowers taxes and insurance	7,488	8,461
Accrued interest payable and other liabilities	11,836	11,089
Total liabilities	1,189,407	1,287,283
<b>Commitments and contingent liabilities</b>		
<b>Stockholders equity</b>		
Preferred Stock, \$0.01 par value, 25,000,000 shares authorized, none issued or outstanding		
Common Stock, \$0.01 par value, shares authorized: 100,000,000; shares issued at December 31, 2007, 22,244,477 and at December 31, 2006, 24,304,950	222	243
Additional paid-in capital	198,449	227,741
Retained earnings, substantially restricted	113,802	113,128
Unearned Employee Stock Ownership Plan shares	(17,126)	(18,105)
Accumulated other comprehensive income (loss)	(4,210)	3,008
Total stockholders equity	291,137	326,015

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Total liabilities and stockholders' equity	\$ 1,480,544	\$ 1,613,298
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See accompanying notes to consolidated financial statements.

## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF INCOME

Years ended December 31, 2007, 2006, and 2005

(In thousands, except per share data)

	2007	2006	2005
Interest and dividend income			
Loans, including fees	\$ 85,601	\$ 83,502	\$ 66,618
Securities	5,056	9,184	11,640
Other	1,296	1,400	1,954
<b>Total interest income</b>	<b>91,953</b>	<b>94,086</b>	<b>80,212</b>
Interest expense			
Deposits	33,446	29,957	20,598
Borrowings	4,858	7,532	8,204
<b>Total interest expense</b>	<b>38,304</b>	<b>37,489</b>	<b>28,802</b>
<b>Net interest income</b>	<b>53,649</b>	<b>56,597</b>	<b>51,410</b>
Provision (credit) for loan losses	697	(136)	518
<b>Net interest income after provision (credit) for loan losses</b>	<b>52,952</b>	<b>56,733</b>	<b>50,892</b>
Noninterest income			
Deposit service charges and fees	3,606	4,198	3,888
Other fee income	1,939	1,916	1,852
Insurance commissions and annuities income	1,007	1,321	848
Gain on sale of loans	126	246	206
Gain on sale of securities	399	101	
Gain on disposition of premises and equipment	9	395	21
Loan servicing fees	811	938	1,031
Amortization and impairment of servicing assets	(396)	(448)	(508)
Operations of real estate owned	(17)	(45)	4
Earnings on BOLI	585		
Other	1,579	1,887	1,323
<b>Total noninterest income</b>	<b>9,648</b>	<b>10,509</b>	<b>8,665</b>
Noninterest expense			
Compensation and benefits	32,276	34,454	28,227
Office occupancy and equipment	5,949	5,602	5,058
Advertising and public relations	1,412	1,193	841
Information technology	3,241	3,341	2,967
Supplies, telephone, and postage	2,109	2,100	1,901
Amortization of intangibles	1,879	1,873	1,634
Visa Litigation	1,240		
Other	4,376	3,807	3,578

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Total noninterest expense	52,482	52,370	44,206
<b>Income before income taxes</b>	10,118	14,872	15,351
Income tax expense	2,963	4,826	4,278
<b>Net income</b>	\$ 7,155	\$ 10,046	\$ 11,073
Basic earnings per common share	\$ 0.35	\$ 0.45	\$ 0.29
Diluted earnings per common share	\$ 0.35	\$ 0.45	\$ 0.29
Weighted average common shares outstanding	20,659,587	22,368,032	22,539,693
Diluted weighted average common shares outstanding	20,659,587	22,372,228	22,539,693

See accompanying notes to consolidated financial statements.



## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY AND

## COMPREHENSIVE INCOME (LOSS)

Years ended December 31, 2007, 2006, and 2005

(In thousands)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Unearned Employee Stock Ownership Plan Shares	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Income (Loss)
<b>Balance at December 31, 2004</b>	\$	\$	\$ 96,455	\$	\$ (1,567)	\$ 94,888	
Comprehensive income							
Net income			11,073			11,073	\$ 11,073
Change in other comprehensive income (loss), net of tax effects					1,420	1,420	1,420
<b>Total comprehensive income</b>							\$ 12,493
Net proceeds from common stock issued	245	240,007		(19,573)		220,679	
ESOP shares earned		228		489		717	
<b>Balance at December 31, 2005</b>	\$ 245	\$ 240,235	\$ 107,528	\$ (19,084)	\$ (147)	\$ 328,777	
Comprehensive income:							
Net income			10,046			10,046	\$ 10,046
Change in other comprehensive income (loss), net of tax effects					3,155	3,155	3,155
<b>Total comprehensive income</b>							\$ 13,201
Purchase and retirement of common stock (977,300 shares)	(10)	(17,280)				(17,290)	
Nonvested stock awards:							
Issuance of shares of restricted stock (816,000 shares)	8	(8)					
Stock-based compensation Expense		4,030				4,030	
Cash dividends declared on common stock (\$0.18 per share)			(4,446)			(4,446)	
ESOP shares earned		764		979		1,743	
<b>Balance at December 31, 2006</b>	\$ 243	\$ 227,741	\$ 113,128	\$ (18,105)	\$ 3,008	\$ 326,015	

(Continued)

## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY AND

## COMPREHENSIVE INCOME (LOSS)

Years ended December 31, 2007, 2006, and 2005

(In thousands)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Unearned Employee Stock Ownership Plan Shares	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Income (Loss)
<b>Balance at December 31, 2006</b>	\$ 243	\$ 227,741	\$ 113,128	\$ (18,105)	\$ 3,008	\$ 326,015	
Comprehensive income (loss):							
Net income			7,155			7,155	\$ 7,155
Change in other comprehensive income (loss), net of tax effects					(7,218)	(7,218)	(7,218)
<b>Total comprehensive income (loss)</b>							\$ (63)
Purchase and retirement of common stock (2,077,923 shares)	(21)	(33,936)				(33,957)	
Nonvested stock awards:							
Issuance of shares of restricted stock (17,450 shares)							
Stock-based compensation Expense		4,075				4,075	
Cash dividends declared on common stock (\$0.28 per share)			(6,481)			(6,481)	
ESOP shares earned		569		979		1,548	
<b>Balance at December 31, 2007</b>	\$ 222	\$ 198,449	\$ 113,802	\$ (17,126)	\$ (4,210)	\$ 291,137	

See accompanying notes to consolidated financial statements.

## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2007, 2006, and 2005

(In thousands)

	2007	2006	2005
<b>Cash flows from operating activities</b>			
Net income	\$ 7,155	\$ 10,046	\$ 11,073
Adjustments to reconcile to net income to net cash			
From operating activities			
Provision (credit) for loan losses	697	(136)	518
ESOP shares earned	1,548	1,743	717
Stock-based compensation expense	4,075	4,030	
Depreciation and amortization	3,863	3,441	3,561
Amortization of premiums and discounts on securities and loans	(319)	(3)	269
Amortization of core deposit and other intangible assets	1,874	1,888	2,109
Amortization and impairment of servicing assets	396	448	508
Amortization of premium on early extinguishment of debt			388
Net change in net deferred loan origination costs	338	117	(445)
Net loss on sale of real estate owned		18	
Net gain on sale of loans	(126)	(246)	(206)
Net gain on sale of securities	(399)	(101)	
Net gain on disposition of premises and equipment	(9)	(395)	(21)
Loans originated for sale	(26,637)	(23,888)	(20,775)
Proceeds from sale of loans	26,888	24,711	26,137
Federal Home Loan Bank of Chicago stock dividends			(1,208)
Net change in:			
Deferred income tax	(438)	2,458	633
Accrued interest receivable	779	(721)	(1,178)
BOLI Income	(585)		
Other assets	(1,989)	(2,287)	(410)
Accrued interest payable and other liabilities	623	(7,725)	8,046
Net cash from operating activities	17,734	13,398	29,716
<b>Cash flows from investing activities</b>			
Securities available-for-sale			
Proceeds from sales	399	229,990	
Proceeds from maturities	1,492,371	51,839	10,656,891
Proceeds from principal repayments	5,866	30,001	45,821
Purchases of securities	(1,445,649)	(95,086)	(10,656,506)
Loans receivable			
Principal payments on loans receivable	807,683	614,604	442,486
Purchases of loans	(3,848)	(34,455)	(113,877)
Originated for investment	(752,752)	(659,864)	(493,514)
Proceeds from redemption of stock in Federal Home Loan Bank		9,836	
Investment BOLI	(19,000)		
Proceeds from sale of real estate owned		114	
Purchase of premises and equipment, net	(2,115)	(1,154)	(2,299)
Cash paid, net of cash and cash equivalents, in acquisition		(13,368)	

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Net cash from investing activities	82,955	132,457	(120,998)
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## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2007, 2006, and 2005

(In thousands)

	2007	2006	2005
<b>Cash flows from financing activities</b>			
Net change in deposits	\$ (55,952)	\$ (41,812)	\$ (47,822)
Net change in advance payments by borrowers for taxes and insurance	(973)	244	895
Net change in borrowings	(41,715)	(53,240)	(73,742)
Net proceeds from sale of common stock			220,679
Repurchase and retirement of common stock	(33,957)	(17,290)	
Cash dividends paid on common stock	(6,481)	(4,446)	
Net cash from financing activities	(139,078)	(116,544)	100,010
Net change in cash and cash equivalents	(38,389)	29,311	8,728
Beginning cash and cash equivalents	67,337	38,026	29,298
<b>Ending cash and cash equivalents</b>	<b>\$ 28,948</b>	<b>\$ 67,337</b>	<b>\$ 38,026</b>
Supplemental disclosures:			
Interest paid	\$ 38,508	\$ 37,366	\$ 28,247
Income taxes paid	3,492	3,670	3,200
Loans transferred to other real estate	820		153
Loans securitized to securities	23,482		24,213
Due to broker	158		
Supplemental Disclosures of Noncash Investing Activities - Acquisition			
Noncash assets acquired:			
Investment securities available for sale	\$	\$ 81,014	\$
Loans, net		17,782	
Premises and equipment, net		2,878	
Goodwill, net		11,714	
Other intangible assets, net		3,272	
Other assets		999	
Total noncash assets acquired		117,659	
Liabilities assumed:			
Deposits	\$	\$ 103,485	\$
Accrued expenses and other liabilities		806	
Total liabilities assumed		104,291	

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Cash paid, net of cash and cash equivalents, in acquisition	\$	\$ 13,368	\$
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See accompanying notes to consolidated financial statements.

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

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

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

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

**Nature of Business:** The Company's revenues, operating income, and assets are primarily from the banking industry. All of the Company's banking operations are considered by management to be aggregated in one reportable operating segment for financial reporting purposes as defined by SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. Loan origination customers are mainly located in the greater Chicago metropolitan area. To supplement loan originations, the Company purchases mortgage loans for which the underlying collateral is predominantly located in Illinois. The loan portfolio is concentrated in loans that are primarily secured by real estate.

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

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





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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

**Securities:** Debt securities are classified as available-for-sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available-for-sale. Securities available-for-sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax. Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sales are based on the amortized cost of the security sold. Declines in the fair value of securities below their cost that are other-than-temporary are reflected as realized losses. In determining if losses are other-than-temporary, management considers: (1) the length of time and extent that fair value has been less than cost or adjusted cost, as applicable (2) the financial condition and near term prospects of the issuer, and (3) the Company's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value.

**Federal Home Loan Bank Stock:** The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost and classified as a restricted security. Because this stock is viewed as a long term investment, impairment is based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

**Loans Held for Sale:** Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or estimated fair market value, as determined by outstanding commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings.

Mortgage loans held for sale are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the fair value of the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

**Loans and Loan Income:** Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of the allowance for loan losses, premiums and discounts on loans purchased, and net deferred loan costs. Interest income on loans is recognized in income over the term of the loan based on the amount of principal outstanding.

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

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

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



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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

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

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

**Mortgage Servicing Rights:** Mortgage servicing rights are recognized separately when they are acquired through sales of loans. For sales of mortgage loans prior to January 1, 2007, a portion of the cost of the loan was allocated to the servicing right based on relative fair values. The Company adopted SFAS No. 156 on January 1, 2007, and for sales of mortgage loans beginning in 2007, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. The Company compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

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

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

**Real Estate Owned:** Real estate properties acquired in collection of a loan are initially recorded at fair value at acquisition, establishing a new cost basis. If fair value declines subsequent to foreclosure, a valuation allowance is recorded through expense. Expenses, gains and losses on disposition, and changes in the valuation allowance are reported in noninterest income.



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)**

**Premises and Equipment:** Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is included in noninterest expense and is computed on the straight-line method over the estimated useful lives of the assets. Useful lives are estimated to be 25 to 40 years for buildings and improvements that extend the life of the original building, 10 to 20 years for routine building improvements, 5 to 15 years for furniture and equipment, 2 to 5 years for computer hardware and software and no greater than 4 years on automobiles. The cost of maintenance and repairs is charged to expense as incurred and significant repairs are capitalized.

**Goodwill and Other Intangible Assets:** Goodwill results from business acquisitions and represents the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Goodwill is assessed at least annually for impairment and any such impairment will be recognized in the period identified. There was no impairment to goodwill for the years ended December 31, 2007, 2006 and 2005.

Other intangible assets consist of core deposit intangible assets arising from whole bank acquisitions. They are initially measured at fair value and then are amortized on an accelerated method over their estimated useful lives.

**Bank Owned Life Insurance:** The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at its cash surrender value (or the amount that can be realized). Upon adoption of EITF 06-5, which is discussed further below, Company owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

In September 2006, the FASB Emerging Issues Task Force finalized Issue No. 06-5, *Accounting for Purchases of Life Insurance Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4 (Accounting for Purchases of Life Insurance)*{Issue}. This Issue requires that a policyholder consider contractual terms of a life insurance policy in determining the amount that could be realized under the insurance contract. It also requires that if the contract provides for a greater surrender value if all individual policies in a group are surrendered at the same time, that the surrender value be determined based on the assumption that policies will be surrendered on an individual basis. Lastly, the Issue requires disclosure when there are contractual restrictions on the Company's ability to surrender a policy.

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

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

**Income Taxes:** Income tax expense is the sum of the current year income tax due or refundable and the change in the deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax consequences of temporary differences between the carrying amounts and tax basis of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

The Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), as of January 1, 2007. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, presuming that a tax examination will occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely to be realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The adoption had no material effect on the Company's financial statements. At December 31, 2007 the Company had unrecognized tax benefits of \$108,000.

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The Company and its subsidiary are subject to U.S. federal income tax as well as income tax of the State of Illinois. The Company is no longer subject to examination by these taxing authorities for years before 2004 for federal

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

income tax and 2003 for the State of Illinois. The Company does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense. At December 31, 2007, the Company had recorded a cumulative accrual of \$20,000 pursuant to FIN 48 for potential interest and penalties.

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

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

**Earnings Per Common Share:** Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. ESOP shares are considered outstanding for this calculation unless unearned. Dilutive earnings per common share is net income divided by the weighted average number of common shares outstanding during the period plus the dilutive effect of restricted stock shares and the additional potential shares issuable under stock options.

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

**Restrictions on Cash:** Cash on hand or on deposit with the Federal Reserve Bank of \$14.7 million and \$11.8 million was required to meet regulatory reserve and clearing requirements at December 31, 2007 and 2006, respectively. These balances do not earn interest.

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

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

**Stock-based Compensation:** In 2006, the Company adopted Statement of Financial Accounting Standards ( SFAS ) No. 123(R), Share-based Payment following stockholder approval of the 2006 Equity Incentive Plan. Accordingly, the Company has recorded stock-based employee compensation cost using the fair value method. Prior to June 27, 2006, there was no stock-based compensation plan.

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





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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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

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

**Effect of Newly Issued But Not Yet Effective Accounting Standards:**

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The standard is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued Staff Position ( FSP ) 157-2, *Effective Date of FASB Statement No. 157*. This FSP delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company is in the process of evaluating the impact of adoption in 2008 to determine the impact on the Company's consolidated financial position or results of operations.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The standard provides companies with an option to report selected financial assets and liabilities at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The new standard is effective for the Company on January 1, 2008. The Company did not elect the fair value option for any financial assets or financial liabilities as of January 1, 2008.

In September 2006, the FASB Emerging Issues Task Force finalized Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. This issue requires that a liability be recorded during the service period when a split-dollar life insurance agreement continues after participants' employment or retirement. The required accrued liability will be based on either the post-employment benefit cost for the continuing life insurance or based on the future death benefit depending on the contractual terms of the underlying agreement. The impact of adoption in 2008 did not have a material impact on the Company's consolidated financial position or results of operations.

On November 5, 2007, the SEC issued Staff Accounting Bulletin No. 109, *Written Loan Commitments Recorded at Fair Value through Earnings* ( SAB 109 ). Previously, SAB 105, *Application of Accounting Principles to Loan Commitments*, stated that in measuring the fair value of a derivative loan commitment, a company should not incorporate the expected net future cash flows related to the associated servicing of the loan. SAB 109 supersedes SAB 105 and indicates that the expected net future cash flows related to the associated servicing of the loan should be included in measuring fair value for all written loan commitments that are accounted for at fair value through earnings. SAB 105 also indicated that internally-developed intangible assets should not be recorded as part of the fair value of a derivative loan commitment, and SAB 109 retains that view. SAB 109 is effective for derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The impact of adoption in 2008 did not have a material impact on the Company's consolidated financial position or results of operations.

**NOTE 2 ACQUISITIONS**

On April 5, 2006, the Company acquired University National Bank, a privately held community bank with approximately \$113 million in assets, including \$10.7 million in cash and cash equivalents, and \$104 million in deposits, and two banking offices in the Hyde Park community in Chicago, Illinois, for approximately \$24 million in cash pursuant to the terms of a Stock Purchase Agreement with University Bancorporation dated November 29,



BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 2 ACQUISITIONS (continued)**

2005. The Company believes that the acquisition of University National Bank will be beneficial as it expands our presence in metropolitan Chicago, compliments our existing branch network and allows for the extension of our products and services into these communities. Immediately upon the completion of the stock purchase, University National Bank was merged into the Bank. The acquisition, which was accounted for under the purchase method of accounting, resulted in goodwill of \$11.7 million and an other intangible of \$3.3 million. The core deposit intangible will be amortized over its estimated useful life. Goodwill will not be amortized but instead evaluated periodically for impairment. The transaction was treated, for federal and state income tax purposes, as a purchase of University National Bank's assets pursuant to applicable provisions of the Internal Revenue Code, making the goodwill and core deposit intangible arising from the transaction tax-deductible over a period of 15 years. University National Bank's results of operations have been included in the Company's results of operations only since the effective date of the acquisition. The acquisition was deemed to be an immaterial acquisition under GAAP, as such additional disclosures have been omitted. The 2007 adjustment of \$13,000 to goodwill is the result of the final settlement of the transition compensation payments and applicable taxes.

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 3 EARNINGS PER SHARE**

Amounts reported in earnings per share reflect earnings available to common stockholders for the period divided by the weighted average number of shares of common stock outstanding during the period, exclusive of unearned ESOP shares and unvested restricted stock shares. Stock options and restricted stock are regarded as potential common stock and are considered in the diluted earnings per share calculations to the extent that they would have a dilutive effect if converted to common stock. Earnings per share for the year ended December 31, 2005 is calculated based on the period of time from the completion date of our mutual-to-stock conversion, June 23, 2005, through the period ended December 31, 2005.

	Year Ended December 31,		
	2007	2006	2005
Net income	\$ 7,155	\$ 10,046	\$ 11,073
Less: net income before conversion			4,457
<b>Net income available to common stockholders</b>	<b>\$ 7,155</b>	<b>\$ 10,046</b>	<b>\$ 6,616</b>
Average common shares outstanding	23,037,710	24,468,293	24,466,250
Less: Unearned ESOP shares	(1,765,359)	(1,863,247)	(1,926,557)
Unvested restricted stock shares	(612,764)	(237,014)	
<b>Weighted average common shares outstanding</b>	<b>20,659,587</b>	<b>22,368,032</b>	<b>22,539,693</b>
<b>Basic earnings per common share</b>	<b>\$ 0.35</b>	<b>\$ 0.45</b>	<b>\$ 0.29</b>

	Year Ended December 31,		
	2007	2006	2005
Net income	\$ 7,155	\$ 10,046	\$ 11,073
Less: net income before conversion			4,457
<b>Net income available to common stockholders</b>	<b>\$ 7,155</b>	<b>\$ 10,046</b>	<b>\$ 6,616</b>
Weighted average common shares outstanding	20,659,587	22,368,032	22,539,693
Add: net effect of dilutive stock options and unvested restricted stock		4,196	
<b>Weighted average dilutive common shares outstanding</b>	<b>20,659,587</b>	<b>22,372,228</b>	<b>22,539,693</b>
<b>Dilutive earnings per common share</b>	<b>\$ 0.35</b>	<b>\$ 0.45</b>	<b>\$ 0.29</b>

Number of antidilutive stock options excluded from the diluted earnings per share calculation	1,597,400	1,301,000	N.A.
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Weighted average exercise price of anti-dilutive option shares	\$	17.40	\$	17.63	N.A.
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N.A. not applicable

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 4 SECURITIES**

The fair value of securities available-for-sale and the related gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) at December 31 is as follows:

	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
<b>2007</b>			
Municipal	\$ 2,272	\$ 62	\$
Mortgage-backed securities	39,277	132	(162)
Collateralized mortgage obligations	3,683	35	(1)
SBA-guaranteed loan participation certificates	592	1	(4)
Equity securities	31,225		(7,050)
	\$ 77,049	\$ 230	\$ (7,217)
<b>2006</b>			
Municipal	\$ 2,711	\$ 52	\$ (1)
Mortgage-backed securities	19,803	161	(69)
Collateralized mortgage obligations	5,881	41	(1)
SBA-guaranteed loan participation certificates	623	1	(6)
Corporate bonds and other securities	45,723		(23)
Equity securities	43,112	4,837	
	\$ 117,853	\$ 5,092	\$ (100)

Mortgage-backed securities and collateralized mortgage obligations consist of Federal Home Loan Mortgage Corporation ( Freddie Mac ), Federal National Mortgage Association ( Fannie Mae ) and Government National Mortgage Association ( Ginnie Mae ) issues at December 31, 2007 and 2006. Equity securities consist of Freddie Mac preferred stock at December 31, 2007 and 2006. All of our investment securities reflected in the preceding table were classified as available-for-sale.

The fair values of securities available-for-sale at December 31, 2007 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.

	<b>2007</b>
Due in one year or less	\$ 476
Due after one year through five years	1,424
Due after five years through ten years	372
	2,272

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Mortgage-backed securities	39,277
Collateralized mortgage obligations	3,683
SBA-guaranteed loan participation certificates	592
Equity securities	31,225
<b>Total</b>	<b>\$ 77,049</b>

Securities pledged at December 31, 2007 and 2006 had a carrying amount of \$40.0 million and \$36.9 million, respectively, and were pledged to secure certain depository relationships, advances from the FHLB of Chicago, and a line of credit with the Federal Reserve Bank of Chicago.



## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 4 SECURITIES (continued)**

Sale of securities available-for-sale were as follows:

	2007	2006	2005
Proceeds	\$ 399	\$ 229,990	\$
Gross gains	399	3,746	
Gross losses		(3,645)	

Securities with unrealized losses at December 31, 2007 and 2006 not recognized in income are as follows:

	Less than 12 Months Unrealized		12 Months or More Unrealized		Total Unrealized	
	Fair Value	Loss	Fair Value	Loss	Fair Value	Loss
<b>2007</b>						
Municipal	\$	\$	\$	\$	\$	\$
Mortgage-backed securities	25,465	137	1,513	25	26,978	162
Collateralized mortgage obligations			269	1	269	1
SBA-guaranteed loan participation certificates			137	4	137	4
Equity securities	31,225	7,050			31,225	7,050
Total temporarily impaired	\$ 56,690	\$ 7,187	\$ 1,919	\$ 30	\$ 58,609	\$ 7,217
<b>2006</b>						
Municipal	\$	\$	\$ 139	\$ 1	\$ 139	\$ 1
Mortgage-backed securities	2,254	9	2,740	60	4,994	69
Collateralized mortgage obligations			42	1	42	1
SBA-guaranteed loan participation certificates	345	1	144	5	489	6
Corporate bonds and equity securities	45,723	23			45,723	23
Total temporarily impaired	\$ 48,322	\$ 33	\$ 3,065	\$ 67	\$ 51,387	\$ 100

Securities with significant declines in fair value are evaluated on a quarterly basis to determine whether they should be considered other-than-temporarily impaired under Securities and Exchange Commission Codification Staff Accounting Bulletins, Topic 5: Miscellaneous Accounting Item M, Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities, which 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 must assess whether the impairment is other-than-temporary. The Company has developed a methodology for conducting periodic impairment testing on marketable equity securities with dividends that adjust periodically based on market interest rate indices (Freddie Mac preferred stocks included in equity securities). A determination of the severity of the impairment and the continuous duration of the impairment (generally as well as the continuous duration of any impairment exceeding 5%) is made.



## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 4 SECURITIES (continued)**

The Company evaluated the securities in our investment portfolio that had significant declines in fair value at December 31, 2007 and 2006, and concluded that the declines were primarily attributable to changes in interest rates rather than credit quality or other issuer-specific factors. Since the Company had the ability and intent at December 31, 2007 and 2006, to hold these investments until a recovery occurred or the securities matured, and the carrying cost of these securities was projected to recover as market interest rates change and or the securities approached maturities, the Company did not consider the declines in fair value to be other-than-temporary impairments. At December 31, 2007, there were unrealized losses aggregating \$7.1 million on the Freddie Mac preferred stocks, but the Company concluded from impairment testing that the unrealized losses did not constitute an other-than-temporary impairment and thus did not record an impairment charge on these securities for the year ended December 31, 2007. No unrealized losses existed at December 31, 2006 with respect to our marketable equity securities.

**NOTE 5 LOANS RECEIVABLE**

Loans receivable are as follows:

	2007	2006
Secured by one- to four-family residential real estate	\$ 345,245	\$ 397,545
Secured by multi-family mortgage loans	291,395	297,131
Nonresidential real estate	325,885	320,729
Construction and land loans	64,483	85,222
Commercial loans	83,233	89,346
Commercial leases	144,841	139,164
Consumer loans	3,506	4,045
Other loans (including municipal)	4,544	4,959
<b>Total loans</b>	<b>1,263,132</b>	<b>1,338,141</b>
Loans in process	(168)	148
Net deferred loan origination costs	2,086	2,424
Allowance for loan losses	(11,051)	(10,622)
<b>Loans, net</b>	<b>\$ 1,253,999</b>	<b>\$ 1,330,091</b>

As of December 31, 2007 and 2006, there were approximately \$213.2 million and \$243.1 million, respectively, of loans purchased from other financial institutions included in the amount of loans secured by one- to four-family residential real estate.

Activity in the allowance for loan losses is as follows:

	2007	2006	2005
Beginning balance	\$ 10,622	\$ 11,514	\$ 11,019
Allowance of acquired bank		212	

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Provision (credit) for loan losses	697	(136)	518
Loans charged off	(305)	(972)	(115)
Recoveries	37	4	92
Ending balance	\$ 11,051	\$ 10,622	\$ 11,514

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 5 LOANS RECEIVABLE (continued)**

Impaired loans were as follows:

	2007	2006
Year-end loans with allocated allowance for loan losses	\$ 6,590	\$ 4,639
Year-end loans with no allocated allowance for loan losses	18,060	17,481
<b>Total</b>	<b>\$ 24,650</b>	<b>\$ 22,120</b>

Amount of the allowance for loan losses allocated	\$ 806	\$ 402
Average of impaired loans during the year	\$ 22,090	\$ 16,409

Cash basis interest income received on impaired loans was approximately \$2.3 million, \$1.4 million, and \$881,000 for the years ended December 31, 2007, 2006, and 2005.

Nonperforming loans were as follows:

	2007	2006
Loans past due over 90 days still on accrual	\$	\$
Nonaccrual loans	12,058	9,226

Nonperforming loans and impaired loans are defined differently. Some loans may be included in both categories, whereas other loans may only be included in one category.

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 6 SECONDARY MORTGAGE MARKET ACTIVITIES**

First mortgage loans serviced for others are not included in the accompanying consolidated statements of financial condition. The unpaid principal balances of these loans were approximately \$292.7 million, \$304.4 million, and \$366.1 million at December 31, 2007, 2006, and 2005, respectively. Custodial escrow balances maintained in connection with the foregoing loan servicing were approximately \$6.1 million, \$7.0 million, and \$7.7 million at December 31, 2007, 2006, and 2005, respectively.

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

	2007	2006
<b>Servicing rights</b>		
Beginning of year	\$ 2,209	\$ 2,526
Additions	348	189
Amortized to expense	(396)	(506)
<b>Balance, end of year</b>	<b>\$ 2,161</b>	<b>\$ 2,209</b>
<b>Valuation allowance</b>		
Beginning of year	\$ 58	\$ 58
Additions expensed	31	
Reductions credited to expense	(31)	(58)
<b>Balance, end of year</b>	<b>\$</b>	<b>\$</b>
<b>Carrying value of mortgage servicing rights</b>	<b>\$ 2,161</b>	<b>\$ 2,209</b>
<b>Fair value of mortgage servicing rights</b>	<b>\$ 2,841</b>	<b>\$ 3,021</b>

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

	2007	2006
Prepayment speed	30.22%	20.79%
Discount rate	12.00%	12.00%
Average servicing cost per loan	\$ 59.00	\$ 60.00
Escrow float rate	3.28%	5.16%



## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 6 SECONDARY MORTGAGE MARKET ACTIVITIES (continued)**

Key economic assumptions used in measuring the fair value of the Company's mortgage servicing rights as of December 31, 2007 and the effect on the fair value of our mortgage servicing rights from adverse changes in those assumptions, are as follows:

Fair value of mortgage servicing rights	\$ 2,841
Weighted average annual prepayment speed	30.22%
Decrease in fair value from 10% adverse change	126
Decrease in fair value from 20% adverse change	242
Weighted-average annual discount rate	12.00%
Decrease in fair value from 10% adverse change	99
Decrease in fair value from 20% adverse change	191

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

The weighted average amortization period is 33 months. The estimated amortization expense for each of the next five years is as follows:

2008	\$ 454
2009	358
2010	283
2011	225
2012	179

**NOTE 7 SECURITIZATIONS**

The Company securitizes conforming adjustable rate residential mortgage loans with Fannie Mae. The Company retains servicing responsibilities for these securitizations. The Company receives annual servicing fees approximating 0.25 percent of the outstanding balance. Fannie Mae has no recourse to the Company's other assets for failure of debtors to pay loans when due. The Company receives securities in exchange for loans in these transactions and records no gain or loss. During 2007, \$23.5 million of adjustable rate residential mortgage loans were securitized and \$24.2 million of adjustable rate residential mortgage loans were securitized in 2005 and the securities received in exchange were classified as available-for-sale. There were no loans securitized during 2006.





## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 8 ACCRUED INTEREST RECEIVABLE**

Accrued interest receivable is summarized as follows:

	2007	2006
Securities	\$ 214	\$ 426
Loans receivable	6,876	7,443
	\$ 7,090	\$ 7,869

**NOTE 9 PREMISES AND EQUIPMENT**

Premises and equipment are as follows:

	2007	2006
Land and land improvements	\$ 11,565	\$ 11,515
Buildings and improvements	30,521	29,729
Furniture and equipment	9,755	9,058
Computer equipment	12,047	11,620
	63,888	61,922
Accumulated depreciation	(29,401)	(26,917)
	\$ 34,487	\$ 35,005

Depreciation of premises and equipment was \$2.6 million, \$2.2 million, and \$2.5 million for the years ended December 31, 2007, 2006, and 2005, respectively.

The Company leases certain branch facilities under noncancelable operating lease agreements expiring through 2032. Rent expense, net of sublease income, for facilities was \$378,000, \$284,000, and \$208,000 in 2007, 2006, and 2005, respectively, excluding taxes, insurance, and maintenance. The projected minimum rental under existing leases, not including taxes, insurance, and maintenance, as of December 31, 2007 is as follows:

2008	\$ 573
2009	406
2010	337
2011	341
2012 and thereafter	7,945

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Total \$ 9,602

The Company has subleased some of these branch facilities and currently is entitled to receive income of approximately:

2008	\$ 96
2009	7
2010	6
Total	\$ 109

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 10 CORE DEPOSIT INTANGIBLE**

Core deposit intangible assets were as follows:

	2007		2006	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets - core deposit intangibles	\$ 18,612	\$ 10,843	\$ 18,612	\$ 8,964

Aggregate amortization expense was \$1.9 million, \$1.9 million and \$1.6 million for 2007, 2006, and 2005, respectively.

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

2008	\$ 1,784
2009	1,690
2010	1,595
2011	1,404
2012	252

**NOTE 11 DEPOSITS**

Year-end deposits are as follows:

	2007	2006
Non-interest-bearing demand	\$ 111,554	\$ 134,097
Interest-bearing NOW	306,517	274,391
Money market	250,682	260,796
Savings	97,280	114,851
Certificates of deposit	307,617	345,450
	\$ 1,073,650	\$ 1,129,585

Certificates of deposit of \$100,000 or more were approximately \$69.6 million and \$94.8 million at year-end 2007 and 2006, respectively.

Certificates of deposit include brokered accounts of \$2.0 million, all internet certificates of deposit, and \$10.4 million, including \$4.2 million of internet certificates of deposit, at December 31, 2007 and 2006, respectively.

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

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2008	\$ 269,452
2009	28,106
2010	7,954
2011	1,114
2012	991

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 11 DEPOSITS (continued)**

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

	2007	2006	2005
Interest-bearing NOW	\$ 6,838	\$ 4,128	\$ 2,290
Money market accounts	11,072	10,096	6,350
Savings	833	1,019	1,005
Certificates of deposit	14,703	14,714	10,953
	\$ 33,446	\$ 29,957	\$ 20,598

**NOTE 12 BORROWINGS**

Borrowed funds are summarized as follows:

	December 31, 2007			December 31, 2006		
	Contractual Range	Interest Rate	Weighted Average Contractual Rate	Amount	Contractual Rate	Weighted Average Contractual Rate
Fixed-rate advance from FHLB due:						
Within 1 year	5.14%	5.14%	5.14%	\$ 10,000	3.61%	\$ 95,000
1 to 2 years	3.84	4.06	3.97	8,000	5.14	10,000
2 to 3 years	3.91	6.44	6.09	29,000		
3 to 4 years					6.44	25,000
Total fixed rate advances	3.84%	6.44%	5.53%	47,000	4.27%	130,000
Open Line advance, due on demand	3.96	3.96	3.96	34,500		
Total FHLB funds	3.84	6.44	4.86	81,500	4.27	130,000
Securities sold under agreements to repurchase	3.84	3.84	3.84	14,933	4.82	8,148
Total borrowings	3.84%	6.44%	4.71%	\$ 96,433	4.30%	\$ 138,148

In July 2003, the Bank elected to pursue certain balance sheet restructuring strategies as a result of the historically low interest rate environment. The restructuring consisted of retiring \$25.0 million of Federal Home Loan Bank ( FHLB ) advances and replacing the other \$145.0 million with new FHLB advances with a weighted average coupon of 1.38% and a weighted average maturity of approximately one year. The Company incurred a net pre-tax prepayment penalty of \$15.4 million, recognized an immediate loss of \$8.3 million on the early extinguishment of debt, and deferred the remaining prepayment penalty in accordance with Emerging Issues Task Force 96-19, *Debtor's Accounting for a Modification or Exchange of Debt Instruments*. The remaining portion of the prepayment penalty was amortized as a yield adjustment over the life of the

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refinanced borrowings. Certain of the Company's borrowings would be subject to prepayment penalties should they be repaid prior to maturity. The prepayment penalty was completely amortized during 2005.

The Company maintains a collateral pledge agreement covering secured advances whereby the Company has agreed to at all times keep on hand, free of all other pledges, liens, and encumbrances, specifically identified whole first mortgages on improved residential property not more than 90-days delinquent to secure advances from the FHLB of Chicago. All stock in the FHLB of Chicago is pledged as additional collateral for these advances. At December 31, 2007, \$207.0 million and \$99.3 million of first mortgage and multi-family mortgage loans, respectively, collateralized the advances. At December 31, 2007, we had the ability to borrow an additional \$206.9 million under our credit facilities with the FHLB of Chicago. Furthermore, we have unpledged securities that could be used to support borrowings in excess of \$25.0 million.

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 12 BORROWINGS (continued)**

At December 31, 2007 and 2006, the Company had available pre-approved overnight federal funds borrowing and repurchase agreement lines of \$65 million. At December 31, 2007 and 2006, the Company also had a line of credit available with the Federal Reserve Bank of Chicago for \$3.1 million and \$20.3 million, respectively. At December 31, 2007 and 2006, there was no outstanding balance on these lines.

**NOTE 13 INCOME TAXES**

The income tax expense is as follows:

	2007	2006	2005
Current	\$ 3,401	\$ 2,368	\$ 3,645
Deferred	(438)	2,458	633
<b>Total income tax expense</b>	<b>\$ 2,963</b>	<b>\$ 4,826</b>	<b>\$ 4,278</b>

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

	2007	2006	2005
Provision computed at the statutory federal tax rate	\$ 3,440	\$ 5,056	\$ 5,219
State taxes and other, net	97	326	(272)
BOLI	(199)		
ESOP	194	260	78
Dividends received deduction	(569)	(816)	(747)
	\$ 2,963	\$ 4,826	\$ 4,278
<b>Effective income tax rate</b>	<b>29.29%</b>	<b>32.45%</b>	<b>27.87%</b>

Retained earnings at December 31, 2007 and 2006 include approximately \$14.9 million for which no deferred federal income tax liability has been recorded. This amount represents an allocation of income to bad debt deductions for tax purposes alone.



## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 13 INCOME TAXES (continued)**

The net deferred tax asset is as follows:

	2007	2006
Gross deferred tax assets		
Allowance for loan losses	\$ 4,261	\$ 4,121
Visa litigation reserve	478	
Alternative minimum tax and capital loss carryforwards	876	1,960
Impairment of securities available for sale	3,403	3,424
Unrealized loss on securities available-for-sale	2,777	
Other	771	636
	12,566	10,141
Gross deferred tax liabilities		
Net deferred loan origination costs	(1,389)	(1,635)
FHLB stock dividends	(1,818)	(1,829)
Purchase accounting adjustments	(2,497)	(3,094)
Accumulated depreciation	(227)	(394)
Mortgage servicing rights	(833)	(857)
Unrealized gain on securities available for sale		(1,984)
Goodwill	(508)	
Other	(360)	(613)
	(7,632)	(10,406)
Net deferred tax asset (liability)	\$ 4,934	\$ (265)

At December 31, 2007, the Company included in deferred tax assets a \$876,000 asset for capital loss carryforwards, which expires in 2011. The alternative minimum tax credits were fully utilized in 2007. Based upon projections of future taxable income, including capital gains, management believes that it is more likely than not that the deferred tax assets will be fully realized and thus a valuation allowance is not needed.

Unrecognized Tax Benefits

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

Balance at January 1, 2007	\$ 192
Additions based on tax positions related to the current year	37
Additions for tax positions of prior years	9

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Reductions for tax positions of prior years	(66)
Reductions due to the statute of limitations	(64)
Settlements	
Balance at December 31, 2007	\$ 108

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 13 INCOME TAXES** (Continued)

The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

The total amount of interest and penalties recorded in the income statement for the year ended December 31, 2007 was \$25,000, and the amount accrued for interest and penalties at December 31, 2007 was \$20,000.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of the state of Illinois. The Company is no longer subject to examination by these taxing authorities for years before 2004 for federal income tax and 2003 for the State of Illinois.

**NOTE 14 REGULATORY MATTERS**

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

The prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required.

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 14 REGULATORY MATTERS (continued)**

At year-end, actual capital levels and minimum required levels for the Bank were:

	Actual		Minimum Required for Capital Adequacy Purposes		Minimum Required to Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>December 31, 2007</u>						
Total capital (to risk-weighted assets)	\$ 213,458	16.54%	\$ 103,259	8.00%	\$ 129,074	10.00%
Tier 1 (core) capital (to risk-weighted assets)	203,213	15.74	51,630	4.00	77,445	6.00
Tier 1 (core) capital (to adjusted total assets)	203,213	13.95	58,278	4.00	72,847	5.00
<u>December 31, 2006</u>						
Total capital (to risk-weighted assets)	\$ 247,253	20.09%	\$ 98,479	8.00%	\$ 123,098	10.00%
Tier 1 (core) capital (to risk-weighted assets)	237,033	19.26	49,239	4.00	73,859	6.00
Tier 1 (core) capital (to adjusted total assets)	237,033	15.05	63,017	4.00	78,771	5.00

The following is a reconciliation of the Bank's equity under GAAP to regulatory capital.

	2007	2006
GAAP equity	\$ 226,828	\$ 268,433
Disallowed intangible assets	(27,825)	(28,392)
Unrealized (gain) loss on securities available-for-sale	4,210	(3,008)
Tier I capital	203,213	237,033
General regulatory loan loss reserves	10,245	10,220
Total regulatory capital	\$ 213,458	\$ 247,253

As of December 31, 2007 and 2006, the most recent notification from the Office of Thrift Supervision categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

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

The Bank is subject to restrictions on the amount of dividends it may declare without prior regulatory approval. The Bank has obtained approval for a \$2.0 million dividend as of January 1, 2008.

**NOTE 15 EMPLOYEE BENEFIT PLANS**

*Employee Stock Ownership Plan ( ESOP )*. Employees are eligible to participate in the ESOP after attainment of age 21 and completion of one year of service. In connection with the conversion and reorganization, the ESOP borrowed \$19.6 million from the Company, and used the proceeds of the loan to purchase 1,957,300 common shares issued in the subscription offering at \$10.00 per share. The loan is secured by shares purchased with the loan proceeds and will be repaid by the ESOP with funds from the Bank's discretionary contributions to the ESOP and

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 15 EMPLOYEE BENEFIT PLANS (continued)**

earnings on ESOP assets. The Bank has committed to make discretionary contributions to the ESOP sufficient to service the loan over a period not to exceed 20 years. When loan payments are made, ESOP shares are allocated to participants based on relative compensation and expense is recorded. Participants receive their earned shares at the end of employment.

Contributions to the ESOP during 2007 and 2006 were \$1.9 million each year. Expense related to the ESOP, net of dividends received on unallocated ESOP shares, was \$1.0 million, \$1.4 million and \$718,000 for the years ended December 31, 2007, 2006 and 2005, respectively.

Shares held by the ESOP were as follows:

	2007	2006
Allocated to participants	244,663	146,797
Distributed to participants	(1,715)	
Unearned	1,712,637	1,810,503
 Total ESOP shares	 1,955,585	 1,957,300
 Fair value of unearned shares	 \$ 27,094	 \$ 32,245

*Profit Sharing Plan/401(k) Plan.* The Company has a defined contribution plan ( profit sharing plan ) covering all of its eligible employees. Employees are eligible to participate in the profit sharing plan after attainment of age 21 and completion of one year of service. The Company matches employee contributions up to 5% of an employee's wages. The Company may also contribute an additional amount annually at the discretion of the Board of Directors. Contributions totaling \$566,000, \$728,000, and \$791,000 were made for the years ended 2007, 2006, and 2005, respectively.

**NOTE 16 EQUITY INCENTIVE PLANS**

On June 27, 2006, the Company's stockholders approved the BankFinancial Corporation 2006 Equity Incentive Plan, which authorized the Human Resources Committee of the Board of Directors of the Company to grant a variety of cash- and equity-based incentive awards, including stock options, stock appreciation rights, restricted stock, performance shares and other incentive awards, to employees and directors aggregating up to 3,425,275 shares of the Company's common stock. The Company has adopted the requirements of SFAS No. 123R, *Share-Based Payment*.

The Human Resources Committee grants stock options to purchase shares of the Company's common stock to certain employees and directors of the Company. The exercise price for the stock options is the fair market value of the common stock on the dates of the grants. The stock options generally vest annually over three to five year periods; vesting is subject to acceleration in certain circumstances. The stock options will expire if not exercised within five years from the date of grant.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. The risk-free interest rate was determined using the yield available on the option grant date for a zero-coupon U.S. Treasury security with a term equivalent to the expected life of the option. The expected life for options granted represents the period the option is expected to be outstanding and was determined by applying the simplified method as allowed by SAB 107. The expected

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volatility was determined using historical volatilities based on historical data for the NASDAQ Bank Index because the Company lacked sufficient history in its stock. Estimated forfeitures were assumed to be zero due to the lack of historical experience for the Company.

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 16 EQUITY INCENTIVE PLANS (continued)**

The Company estimated the grant date fair value of options awarded in fiscal 2007 and 2006 using the Black-Scholes Option-Pricing model with the following assumptions:

	2007 Assumptions	2006 Assumptions
Risk-free interest rate	4.47%	4.69%
Expected option life (years)	3.42	3.57
Expected stock price volatility	11.06%	11.29%
Current quarterly cash dividend	\$ 0.07	\$ 0.06
Projected dividend growth	5.00%	5.00%
Weighted average fair value of options granted during year	\$ 0.853	\$ 1.458

The Company recognized \$498,000 and \$413,000 of stock-based compensation expenses relating to the granting of stock options for the year ended December 31, 2007 and 2006, respectively. As of December 31, 2007, the Company had \$1.2 million of total unrecognized compensation cost related to unvested stock options. The cost is expected to be recognized over a weighted average period of 1.5 years as follows:

2008	\$ 458
2009	401
2010	369
2011	17

Stock Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value <sup>(1)</sup>
Stock options outstanding at December 31, 2006	1,301,000	\$ 17.63	4.7	\$ 234
Stock options granted	301,200	15.89		
Stock options exercised				
Stock options forfeited	(4,800)	(16.00)		
Stock options outstanding at December 31, 2007	1,597,400	\$ 17.40	3.9	\$
Stock options exercisable at December 31, 2007	617,120	\$ 17.48	4.0	\$
Fully vested and expected to vest	1,597,400	\$ 17.40	3.9	\$



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

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 16 EQUITY INCENTIVE PLANS (continued)**

The Company grants shares of restricted stock to certain employees and directors of the Company. The awards generally vest annually over varying periods from three to five years and vesting is subject to acceleration in certain circumstances. The cost of such awards will be accrued ratably as compensation expense over such respective periods based on expected vesting dates. The Company recognized \$3.6 million of expenses relating to the grant of shares of restricted stock during each of the years ended December 31, 2007 and 2006. As of December 31, 2007 and 2006, the total unrecognized compensation cost related to unvested shares of restricted stock was \$7.4 million and \$10.8 million, respectively. The cost is expected to be recognized over a weighted average period of 1.3 years is as follows:

2008	\$ 3,531
2009	2,151
2010	1,767

	Number of Shares <sup>(2)</sup>	Weighted Average Fair Value at Grant Date	Weighted Average Term to Vest (in years)	Aggregate Intrinsic Value <sup>(3)</sup>
<b>Restricted Stock</b>				
Shares outstanding at December 31, 2005		\$		
Shares granted	816,000	17.63		
Shares vested	(174,050)	17.63		
Shares forfeited				
Shares outstanding at December 31, 2006	641,950	\$ 17.63	2.2	\$ 11,433
Shares granted	17,450	15.41		
Shares vested	(224,250)	17.63		
Shares forfeited				
Shares outstanding at December 31, 2007	435,150	\$ 17.57	1.8	\$ 6,884

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

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



## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 17 LOAN COMMITMENTS AND OTHER OFF-BALANCE SHEET ACTIVITIES**

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

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

The contractual or notional amounts are as follows:

	2007	2006
Financial instruments wherein contractual amounts represent credit risk		
Commitments to extend credit	\$ 17,608	\$ 22,849
Standby letters of credit	4,140	3,464
Unused lines of credit	218,820	233,229
Commitments to sell mortgages	2,796	2,836

Commitments to extend credit are generally made for periods of 60 days or less. The fixed-rate loans commitment totaled \$13.6 million with interest rates ranging from 5.25% to 6.875% and maturities ranging from 1 to 30 years.

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

Pursuant to the bylaws of Visa USA, the Company is obligated to indemnify Visa, Inc. for certain litigation losses. On October 3, 2007, a Loss Sharing Agreement became effective which reaffirmed the Company's obligation to indemnify Visa, Inc. for potential future settlement of certain litigation. The Company's indemnification obligation is limited to its proportionate equity interest in Visa USA. During 2007, Visa announced that it had recognized liabilities for probable settlements for two of the covered suits. The Company has accrued its proportionate share of these anticipated settlements. In addition, the Company has recognized a guarantee liability for the other covered suits. As of December 31, 2007, the Company's estimated liability related to its obligation to indemnify Visa for covered litigation was \$1.24 million.

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 18 FAIR VALUES OF FINANCIAL INSTRUMENTS**

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

	2007		2006	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets</b>				
Cash and cash equivalents	\$ 28,948	\$ 28,948	\$ 67,337	\$ 67,337
Securities	77,049	77,049	117,853	117,853
Loans held-for-sale	173	173	298	298
Loans receivable, net of allowance for loan losses	1,253,999	1,262,624	1,330,091	1,330,778
FHLB stock	15,598	15,598	15,598	15,598
Accrued interest receivable	7,090	7,090	7,869	7,869
Mortgage servicing rights	2,161	2,841	2,209	3,021
<b>Financial liabilities</b>				
Non-interest-bearing demand deposits	\$ (111,554)	\$ (111,554)	\$ (134,097)	\$ (134,097)
NOW and money market deposits	(557,199)	(557,199)	(535,187)	(535,187)
Savings	(97,280)	(97,280)	(114,851)	(114,851)
Certificates of deposit	(307,617)	(309,522)	(345,450)	(346,481)
Borrowings	(96,433)	(98,406)	(138,148)	(138,805)
Accrued interest payable	(980)	(980)	(1,184)	(1,184)

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.

**Securities:** The estimated fair values of securities are based on quoted market prices when they are currently available. If a quoted market price for a specific security is not currently available, the Company estimates the fair value based on the quoted market price of another security with similar characteristics, adjusted to reflect objectively measurable differences such as coupon rates and reset dates. In the absence of current quoted market prices for the same or a similar security, the Company uses other valuation techniques to determine fair value, such as obtaining broker-dealer valuations or estimating fair value based on valuation modeling. Significant judgment is involved in determining fair value in the absence of current quoted market prices.

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

**Mortgage servicing rights:** The estimated fair value of mortgage servicing rights is the present value of the expected future cash flows over the projected life of the loan. Assumptions used in the present value calculation are based on actual performance of the underlying servicing along with general market consensus.

**Deposit Liabilities:** The estimated fair value for certificate deposits 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 non-interest-bearing demand, NOW, money market, and savings deposits are assumed to approximate their carrying values as management

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establishes rates on these deposits at a level that approximates the local market area. Additionally, these deposits can be withdrawn on demand.

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 18 FAIR VALUES OF FINANCIAL INSTRUMENTS (continued)**

**Borrowings:** The estimated fair values of advances from the FHLB and note 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 19 OTHER COMPREHENSIVE INCOME (LOSS)**

Other comprehensive income (loss) components and related taxes were as follows:

	2007	2006	2005
Unrealized holding gains (losses) on securities available-for-sale	\$ (11,979)	\$ 5,237	\$ 2,355
Tax effect	4,994	(2,020)	(935)
Unrealized holding gains (losses) on securities available-for-sale, net of tax	(6,985)	3,217	1,420
Less reclassification adjustments for net gains recognized in income	(399)	(101)	
Tax effect	166	39	
Less reclassification adjustments for net gains recognized in income, net of tax	(233)	(62)	
Other comprehensive income (loss)	\$ (7,218)	\$ 3,155	\$ 1,420





BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 20 COMPANY ONLY CONDENSED FINANCIAL INFORMATION**

Condensed financial information of BankFinancial Corporation as of December 31, 2007, 2006 and 2005 follows:

**Condensed Statements of Financial Condition**

	2007	2006
<b>ASSETS</b>		
Cash in subsidiary	\$ 44,232	\$ 36,805
Loan receivable from ESOP	18,341	18,870
Investment in subsidiary	226,827	268,433
Other assets	1,928	1,907
Total assets	\$ 291,328	\$ 326,015
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Accrued expenses and other liabilities	191	
Total stockholders equity	291,137	326,015
Total liabilities and stockholders equity	\$ 291,328	\$ 326,015

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 20 COMPANY ONLY CONDENSED FINANCIAL INFORMATION (continued)****Condensed Statements of Income**

	2007	2006	2005
Interest income	\$ 1,321	\$ 1,355	\$ 717
Dividends from subsidiary	47,500	10,500	
Other expense	1,864	1,529	377
Income before income tax and undistributed subsidiary income	46,957	10,326	340
Income tax expense (benefit)	(209)	(66)	128
Income before equity in undistributed subsidiary income	47,166	10,392	212
Equity in undistributed subsidiary income (excess distributions)	(40,011)	(346)	10,861
Net income	\$ 7,155	\$ 10,046	\$ 11,073

**Condensed Statements of Cash Flows**

	2007	2006	2005
<b>Cash flows from operating activities</b>			
Net income	\$ 7,155	\$ 10,046	\$ 11,073
Adjustments			
Equity in undistributed subsidiary income	40,011	346	(10,861)
Change in other assets	(21)	387	(2,232)
Change in accrued expenses and other liabilities	191	(1,111)	1,111
<b>Net cash from operating activities</b>	47,336	9,668	(909)
<b>Cash flows from investing activities</b>			
Cash paid in acquisition		(23,943)	
Principal payments received on ESOP loan	529	495	208
Capital contribution to subsidiary bank			(147,859)
<b>Net cash from investing activities</b>	529	(23,448)	(147,651)
<b>Cash flows from financing activities</b>			
Repurchase and retirement of common stock	(33,957)	(17,290)	
Cash dividends paid on common stock	(6,481)	(4,446)	
Net proceeds from sale of common stock			220,679

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<b>Net cash from financing activities</b>	(40,438)	(21,736)	220,679
Net change in cash and cash equivalents	7,427	(35,516)	72,119
Beginning cash and cash equivalents	36,805	72,321	202
<b>Ending cash and cash equivalents</b>	<b>\$ 44,232</b>	<b>\$ 36,805</b>	<b>\$ 72,321</b>

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 21 SELECTED QUARTERLY FINANCIAL DATA (Unaudited)**

	Year Ended December 31, 2007			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest Income	\$ 23,793	\$ 23,111	\$ 23,124	\$ 21,925
Interest Expense	9,765	9,760	9,899	8,880
Net interest income	14,028	13,351	13,225	13,045
Provision (credit) for loan losses	581	(354)	460	10
Net interest income	13,447	13,705	12,765	13,035
Non interest income	2,042	2,327	2,777	2,502
Non interest expense	13,122	12,666	12,383	14,311
Income before income taxes	2,367	3,366	3,159	1,226
Income tax expense	716	1,028	922	297
Net Income	\$ 1,651	\$ 2,338	\$ 2,237	\$ 929
Basic earnings per common share	\$ 0.08	\$ 0.11	\$ 0.11	\$ 0.05
Diluted earnings per common share	\$ 0.08	\$ 0.11	\$ 0.11	\$ 0.05
	Year Ended December 31, 2006			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Interest Income	\$ 22,292	\$ 23,683	\$ 24,244	\$ 23,867
Interest Expense	8,480	9,363	9,792	9,854
Net interest income	13,812	14,320	14,452	14,013
Provision (credit) for loan losses	196	156	49	(537)
Net interest income	13,616	14,164	14,403	14,550
Non interest income	2,731	2,587	2,658	2,533
Non interest expense	11,628	12,457	12,895	15,390
Income before income taxes	4,719	4,294	4,166	1,693
Income tax expense	1,579	1,390	1,371	486
Net Income	\$ 3,140	\$ 2,904	\$ 2,795	\$ 1,207
Basic earnings per common share	\$ 0.14	\$ 0.13	\$ 0.12	\$ 0.06
Diluted earnings per common share	\$ 0.14	\$ 0.13	\$ 0.12	\$ 0.06

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We had net income of \$929,000 for the fourth quarter of 2007. Our operating results for the fourth quarter of 2007 included a pre-tax charge of \$1.2 million, which reflected our proportionate share of Visa's estimated litigation obligations. The charge was recorded because BankFinancial, like other Visa USA members, is obligated to share expenses, resulting from certain indemnified Visa litigation, proportionately with its ownership interests in Visa USA.

Our operating results for the fourth quarter of 2007 included a \$1.2 million pre-tax expense for equity-based compensation and benefits, compared to a \$3.5 million amount recorded in the fourth quarter of 2006. These expenses relate in substantial part to the vesting of equity-based awards that were made in 2006 pursuant to the Equity Incentive Plan that our stockholders approved, and to expenses arising from the ESOP that we established in connection with our mutual-to-stock conversion in June of 2005.

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

**NOTE 22 MUTUAL TO STOCK CONVERSION**

On June 23, 2005, the Company completed the conversion from a mutual holding company form of organization to the stock form of organization and sold 24,466,250 shares of common stock at \$10.00 per share in a subscription offering to eligible account holders, the Company's tax-qualified employee benefit plans, supplemental eligible account holders and other members of the Company.

At the time of conversion, the Company established a liquidation account in an amount equal to its net worth as of December 31, 2004. The liquidation account represents a calculated amount for the purposes described below, and it does not represent actual funds included in the consolidated financial statements of the Company. The liquidation account will be maintained for the benefit of eligible depositors who continue to maintain their accounts at the Company after conversion. The liquidation account will be reduced annually to the extent that eligible depositors have reduced their qualifying deposits. Subsequent increases will not restore an eligible account holder's interest in the liquidation account. In the unlikely event of a complete liquidation, each eligible depositor will be entitled to receive a distribution from the liquidation account in an amount proportionate to the current adjusted qualifying balances for the accounts held. Accordingly, retained earnings of the Company are deemed to be restricted up to the balance of the liquidation account.

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

Not Applicable

**ITEM 9A. CONTROLS AND PROCEDURES**

(a) Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of our management, including our Principal Executive Officer and Principal Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the fiscal year (the Evaluation Date ). Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective in timely alerting them to the material information relating to us (or our consolidated subsidiaries) required to be included in our periodic Securities and Exchange Commission filings.

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

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

(c) Changes in internal controls.

There were no changes made in our internal controls during the period covered by this report or, to our knowledge, in other factors that have materially affected, or are reasonably likely to materially affect these controls.

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

**ITEM 9B. OTHER INFORMATION**

Not Applicable.

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

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

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

**Code of Ethics.** We have adopted a Code of Ethics for Senior Financial Officers that applies to our principal executive officer, principal financial officer, principal accounting officer, and persons performing similar functions. A copy of our Code of Ethics is attached as Exhibit 14 to our Annual Report on Form 10-K for the year ended December 31, 2006. We have also adopted a Code of Business Conduct, pursuant to Nasdaq requirements, that applies generally to our directors, officers, and employees.

**ITEM 11. EXECUTIVE COMPENSATION**

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

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

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

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

The following table sets forth information regarding the securities that were authorized for issuance under our 2006 Equity Incentive Plan as of December 31, 2007:

	(Column A)	(Column B)	(Column C)
Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance under 2006 Equity Incentive Plan (Excluding Securities Reflected in Column (A))
Equity compensation plans approved by stockholders	2,032,550	\$ 17.40	994,525
Equity compensation plans not approved by stockholders			
<b>Total</b>	<b>2,032,550</b>	<b>17.40</b>	<b>994,525</b>

Column (A) represents stock options and restricted stock outstanding under the Company's 2006 Equity Incentive Plan. Future equity awards under the 2006 Equity Incentive Plan may take the form of stock options, stock appreciation rights, performance unit awards, restricted stock, restricted performance stock, restricted stock units, stock awards or cash. Column (B) represents the weighted-average exercise price of the outstanding stock options only; the outstanding restricted stock awards are not included in this calculation. Column (C) represents the maximum aggregate number of future equity awards that can be made under the 2006 Equity Incentive Plan as of December 31, 2007.





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

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

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

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

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a)(1) Financial Statements

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

- (A) Report of Independent Registered Accounting Firm
- (B) Consolidated Statements of Financial Condition at December 31, 2007 and 2006
- (C) Consolidated Statements of Operations for the years ended December 31, 2007, 2006 and 2005
- (D) Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2007, 2006 and 2005
- (E) Consolidated Statements of Cash Flows for the years ended December 31, 2007, 2006 and 2005
- (F) Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules

None.

(a)(3) Exhibits

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

<b>Exhibit</b>	<b>Location</b>
3.1 Articles of Incorporation of BankFinancial Corporation	Exhibit 3.1 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities

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- and Exchange Commission on September 23, 2004
- 3.2 Bylaws of BankFinancial Corporation Exhibit 3.2 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
- 3.3 Articles of Amendment to Charter of BankFinancial Corporation Exhibit 3.3 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004

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3.4	Restated Bylaws of BankFinancial Corporation	Exhibit 3.4 to the Annual Report on Form 10K of the Company (file no. 0001193125-07-054748), filed with the Securities and Exchange Commission on March 15, 2007.
4	Form of Common Stock Certificate of BankFinancial Corporation	Exhibit 4 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
10.1	Employee Stock Ownership Plan	Exhibit 10.1 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
10.2	Deferred Compensation Plan	Exhibit 10.2 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
10.3	Employment Agreement with F. Morgan Gasior	Exhibit 10.3 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
10.4	Employment Agreement with James J. Brennan	Exhibit 10.4 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
10.5	Employment Agreement with Paul A. Cloutier	Exhibit 10.5 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
10.6	Employment Agreement with Robert J. O. Shaughnessy	Exhibit 10.6 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
10.7	Employment Agreement with Christa N. Calabrese	Exhibit 10.7 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
10.8	Form of Employment Agreement with F. Morgan Gasior	Exhibit 10.10 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
10.9	Form of Employment Agreement with Senior Executive Officers	Exhibit 10.11 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
10.11	Form of Employment Agreement for Named Executive Officers	Exhibit 10.14 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
10.12	Form of Incentive Stock Option Award Terms	Exhibit 10.1 to the Report on Form 8-K of the Company filed with the Securities and Exchange Commission on September 5, 2006
10.13	2006 BankFinancial Corporation Equity Incentive Plan	Appendix C to the Definitive Form 14A filed with the Securities and Exchange Commission on May 25, 2006 (File No. 000-51331)
10.14	Form of Performance Based Incentive Stock Option Award Terms	Exhibit 10.2 to the Report on Form 8-K of the Company filed with the Securities and Exchange

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		Commission on September 5, 2006
10.15	Form of Non-Qualified Stock Option Award Terms	Exhibit 10.3 to the Report on Form 8-K of the Company filed with the Securities and Exchange Commission on September 5, 2006
10.16	Form of Performance Based Non-Qualified Stock Option Award Terms	Exhibit 10.4 to the Report on Form 8-K of the Company filed with the Securities and Exchange Commission on September 5, 2006
10.17	Form of Restricted Stock Unit Award Agreement	Exhibit 10.5 to the Report on Form 8-K of the Company filed with the Securities and Exchange Commission on September 5, 2006
10.18	Form of Performance Based Restricted Stock Award Agreement	Exhibit 10.6 to the Report on Form 8-K of the Company filed with the Securities and Exchange Commission on September 5, 2006
10.19	Form of Restricted Stock Award Agreement	Exhibit 10.7 to the Report on Form 8-K of the Company filed with the Securities and Exchange Commission on September 5, 2006
10.20	Form of Stock Appreciation Rights Agreement	Exhibit 10.8 to the Report on Form 8-K of the Company filed with the Securities and Exchange Commission on September 5, 2006
14	Code of Ethics for Senior Financial Officers	Exhibit 14 to the Annual Report on Form 10-K of the Company (file no. 0001193125-06-064000), filed with the Securities and Exchange Commission on March 27, 2006
21	Subsidiaries of Registrant	Exhibit 21 to the Registration Statement on Form S-1 of the Company (file no. 333-119217), originally filed with the Securities and Exchange Commission on September 23, 2004
23	Consent of Crowe Chizek and Company LLC	Filed herewith
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Filed herewith
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*	Furnished herewith

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

**SIGNATURES**

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

**BANKFINANCIAL CORPORATION**

Date: March 12, 2008

By: /s/ F. Morgan Gasior  
 F. Morgan Gasior  
 Chairman of the Board, Chief Executive Officer and President  
 (Duly Authorized Representative)

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

<b>Signatures</b>	<b>Title</b>	<b>Date</b>
/s/ F. Morgan Gasior F. Morgan Gasior	Chairman of the Board, Chief Executive Officer and President (Principal Executive Officer)	March 12, 2008
/s/ Paul A. Cloutier Paul A. Cloutier	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 12, 2008
/s/ Cassandra J. Francis Cassandra J. Francis	Director	March 12, 2008
/s/ John M. Hausmann John M. Hausmann	Director	March 12, 2008
/s/ Sherwin R. Koopmans Sherwin R. Koopmans	Director	March 12, 2008
/s/ Joseph A. Schudt Joseph A. Schudt	Director	March 12, 2008
/s/ Terry R. Wells Terry R. Wells	Director	March 12, 2008
/s/ Glen R. Wherfel Glen R. Wherfel	Director	March 12, 2008