

CENTRAL FEDERAL CORP

Form 424B1

January 11, 2006

**Table of Contents**Filed Pursuant to Rule 424(b)(1)  
Registration No. 333-129315

## PROSPECTUS

**2,000,000 Shares  
Common Stock**

We are Central Federal Corporation, a Delaware corporation and the holding company for CFBank, a federally-chartered savings association located in the State of Ohio.

We are offering for sale 2,000,000 shares of our common stock in an underwritten public offering. The offering is being made only in the States of California, Connecticut, Florida, Georgia, Illinois, Indiana, Maryland, Michigan, New Jersey, New York, Ohio, Pennsylvania, Wisconsin, the Commonwealths of Massachusetts and Virginia, where the common stock has been registered or qualified for sale. Our common stock is traded on the Nasdaq<sup>®</sup> Capital Market under the symbol CFBK. The last reported sale price for our common stock was \$7.75 per share on January 10, 2006.

**Investing in our common stock involves risks. Before making an investment decision, we urge you to read carefully the Risk Factors beginning on page 6.**

**Neither the Securities and Exchange Commission nor the Office of Thrift Supervision or any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

**The securities offered by this prospectus are not savings accounts or deposits, and they are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other governmental agency.**

	<b>Per Share</b>	<b>Total</b>
Public offering price	\$ 7.00	\$ 14,000,000
Underwriting commissions to be paid by us(1)	\$ 0.49	\$ 980,000
Net proceeds before expenses to be received by us	\$ 6.51	\$ 13,020,000

- (1) This is a firm commitment underwriting by Ryan Beck & Co. We will pay underwriting commissions on the sale of the shares of common stock to the public. Ryan Beck & Co. has been granted a 30-day option to purchase up to an additional 300,000 shares of common stock to cover over-allotments, if any. See Underwriting.

Ryan Beck & Co.

The date of this prospectus is January 10, 2006

**Table of Contents**

---

**TABLE OF CONTENTS**

<u>Prospectus Summary</u>	1
<u>Risk Factors</u>	6
<u>Forward-Looking Statements</u>	12
<u>Use of Proceeds</u>	13
<u>Market for Our Common Stock and Dividends</u>	14
<u>Capitalization</u>	16
<u>Selected Consolidated Financial Information</u>	17
<u>Supplementary Consolidated Financial Information</u>	20
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	36
<u>Business</u>	38
<u>Management</u>	56
<u>Regulation and Supervision</u>	59
<u>Description of Our Common Stock</u>	69
<u>Principal Stockholders</u>	74
<u>Underwriting</u>	76
<u>Interests of Named Experts and Counsel</u>	78
<u>Incorporation of Certain Information by Reference</u>	78
<u>Where You Can Find Additional Information</u>	78
<u>Commission Position on Indemnification for Securities Act Liabilities</u>	79
<u>Index to Financial Statements</u>	F-1

**Table of Contents**

**PROSPECTUS SUMMARY**

This summary highlights selected information contained in this prospectus. Because this is a summary, it may not contain all the information important to you. Therefore, you also should read the entire prospectus carefully, especially the risks of investing in our common stock discussed under Risk Factors, as well as our consolidated financial statements included in this prospectus. Unless otherwise indicated, the information in this prospectus assumes that the underwriter will not exercise its option to purchase additional common stock to cover over-allotments. Any references in this prospectus to we, us, our, the holding company or Central Federal refers to Central Federal Corporation and its consolidated subsidiaries, unless otherwise specified. Any reference to CFBank or the bank refers to our principal operating subsidiary, CFBank.

**Who We Are**

Central Federal Corporation is a savings and loan holding company incorporated in Delaware in 1998 under the name Grand Central Financial Corp. On April 23, 2003, we changed our name to Central Federal Corporation. Our primary business is the operation of our principal subsidiary, CFBank. CFBank is a federally-chartered savings association formed in Ohio in 1892. Earlier known as Central Federal Savings and Loan Association, the bank changed its name to Central Federal Bank on February 20, 2003 and to CFBank on April 20, 2004. In 1998, the bank converted from a mutual to a stock form of organization and, in connection with the conversion, we sold 1,955,000 shares of our common stock to our depositors and the general public. The bank is headquartered in Fairlawn, Ohio, and has additional full-service offices in Calcutta, Ohio; Columbus, Ohio; and Wellsville, Ohio. The bank has a residential mortgage origination office in Akron, Ohio. In 2003, we formed Central Federal Capital Trust I for the purpose of issuing 5.0 million of 3-month LIBOR plus 2.85% floating rate trust preferred securities. In 2003 we formed Smith Ghent LLC, an Ohio limited liability company, with S&H Investment, Ltd. We own 33.3% of Smith Ghent, and S&H Investments owns 66.7% of Smith Ghent. Smith Ghent owns the real estate of our Fairlawn office. At September 30, 2005 we had consolidated assets of \$157.9 million, net loans of \$107.0 million, total deposits of \$120.7 million and stockholders' equity of \$17.2 million.

The following chart shows our organizational structure:

CFBank's principal business consists of attracting deposits from the general public in its primary market areas and investing those deposits and other funds generated from operations and from Federal Home Loan Bank of Cincinnati (FHLB) advances, primarily in commercial real estate and business loans and conventional mortgage loans secured by single-family residences throughout Ohio. The bank also invests in consumer loans, home equity, multi-family, construction and land loans and mortgage-backed securities, primarily those guaranteed or insured by government agencies and other investment grade securities.

From the time of our mutual-to-stock thrift conversion in 1998 through 2002, we operated as an overcapitalized company exhibiting limited growth potential and earnings that were well below industry averages in terms of returns on average assets and equity. In order to increase our growth

**Table of Contents**

potential and earnings and to more effectively deploy our capital, our board of directors recognized that we needed to strengthen our management team, move into more rapidly growing markets and expand into business banking in order to be properly positioned to deliver long-term shareholder value.

Adding experienced bankers to our management team and opening new offices in Fairlawn and Columbus has been expensive in the short-term, and our level of net interest income has not been sufficient to cover our increased overhead levels since we embarked on this strategy. We have undertaken significant restructuring costs, such as severance costs, termination of our Employee Stock Ownership Plan, freezing of our defined benefit plan and restructuring of our FHLB debt. We believe that we have largely completed the restructuring of our management team and balance sheet, and we believe that we are poised to become a profitable community bank and to continue our growth following this offering. The capital provided by this offering will enable us to expand our lending limit and further penetrate our new markets.

We emphasize personalized service, access to decision makers, timely response to loan requests and loan processing and the convenience of telephone banking, corporate cash management and online internet banking for our depositors.

**Our Market Area**

Our principal market area for customer loans and deposits includes the following Ohio counties: Summit County through our office in Fairlawn, Ohio; Franklin County through our office in Columbus, Ohio; and Columbiana County through our offices in Calcutta and Wellsville, Ohio. We originate commercial and conventional real estate loans and business loans throughout Ohio.

Historically, our primary market area for customer deposits and loans was Columbiana County, Ohio, where two of our offices are located. The East Liverpool-Salem Metropolitan Statistical Area (MSA), which includes Columbiana County, has a population in 2005 of 110,000 and a median household income of \$39,000, according to SNL Financial.

The Columbiana County market, while stable and important to us, is experiencing stagnant to slightly declining population growth, and its median household income is well below the statewide median of \$49,000. However, while not a growth area, Columbiana County has the 15<sup>th</sup> highest level of deposits of the state's 88 counties.

When we changed management and the strategic direction of the bank beginning in 2003, we entered two markets which exhibit substantially greater growth potential, as well as a far greater concentration of potential business banking customers. The Akron MSA, which is served by our Fairlawn office, has an estimated 2005 population of 710,000 and a median household income level of \$52,000. The Columbus MSA is even more attractive, with an estimated 2005 population of 1.8 million and a median household income of \$54,000. All demographic information has been obtained from SNL Financial.

In terms of bank deposits as of June 30, 2005 (the most recent date for which data are available) according to the FDIC, the East Liverpool-Salem MSA had \$2.0 billion in total deposits. By contrast, the Akron MSA had \$9.9 billion and the Columbus MSA had \$28.8 billion. Our Fairlawn office is in close proximity to the Cleveland MSA, which had \$64.5 billion, the highest level in the state. While we recognize that we have many well-established competitors in our new markets, we believe that we will be able to achieve significant growth in these markets over the next several years.

## **Table of Contents**

We also extend our reach by utilizing technology and services to gather deposits without requiring customers to visit our offices. Customers may access their accounts through our website, [www.CFBankonline.com](http://www.CFBankonline.com), and make deposits through any of the 814 ATMs in the network to which we belong, through a local courier service we provide or through the use of check scanners which can be onsite at a client's office, enabling immediate recognition of funds.

### **Our Growth and Profitability Strategy**

We provide personalized banking services to satisfy the needs of our individual and business customers, and we are striving to position our business for long-term growth and profitability. Our strategy to achieve growth and profitability has the following components:

*Management* In 2003, we began to put in place a strong senior management team with extensive banking experience in the geographical and product markets we serve. We believe it is unusual for a community bank to have a management team as experienced as ours. There has been significant industry consolidation in our markets in recent years, and we believe a substantial segment of the market is eager to do business with experienced bankers who provide exemplary service and prompt decisions.

*Growth Markets* With the change in management, we also adopted an ambitious growth plan to reposition the bank. In 2003, we began a transition from our historical role as a thrift with an emphasis on making single family mortgage loans in Columbiana County to a balanced community bank. As part of the transition, we have opened additional offices in Franklin and Summit Counties, Ohio, where higher population and median income levels offer far greater potential for growth and profitability. Along with our expansion into growth markets, we are shifting our focus to more fully serving the more profitable commercial and commercial real estate loan markets. We are also enhancing our mortgage loan capabilities. We intend to consider every reasonable channel to originate loans, including the internet and other technology.

*Customer Service* We intend to differentiate ourselves from our competitors by providing excellent customer service, including prompt credit decisions. We provide personalized banking services, as we strive to meet the individual financial needs and objectives of our customers and offer appropriate services to meet those needs and objectives. We pride ourselves on giving our customers ready access to decision makers, and we limit the number of accounts served by each of our officers so that our customers can receive personal attention, and we can fully develop our business relationship with each customer. We also provide courier service for deposits, and we believe that we are a leader in our markets in utilizing technology to enhance the level of convenience for our customers.

*Asset Quality* Historically, we have had excellent asset quality, which we will be careful to maintain, as we expand our lending activities. We have a team of very experienced lenders, and we believe we have developed a stronger credit review process than would typically be seen at a community bank. With an increased legal lending limit as a result of this offering, we plan to significantly increase our loan portfolio while maintaining superior asset quality through conservative underwriting practices. Historically, we have experienced a very low level of charge-offs and past due loans.

### **Management Team**

Our management team has extensive experience in commercial and residential real estate lending activities and deep ties to our markets. Most of our executives have served in leadership positions in companies that are much larger than we are.

**Table of Contents**

Our former Chairman, David C. Vernon, now Vice-Chairman, has worked for more than 40 years in banking in our markets. He founded Summit Bank in Akron in 1991, which operated very successfully until its acquisition by FirstFederal Financial Services Corp. in 1997. Mr. Vernon held previous leadership positions with the Firestone Bank and Bank One Akron NA. On January 1, 2006, he retired as Chairman and assume the role of Vice-Chairman.

Mark S. Allio, Chairman, President and Chief Executive Officer of Central Federal and Chairman and Chief Executive Officer of the bank, has more than 29 years of banking and banking-related experience, including service as President and Chief Executive Officer of Rock Bank in Livonia, Michigan, an affiliate of Quicken Loans, Inc. He was previously President of Third Federal Savings, MHC in Cleveland, Ohio, a multi-billion dollar thrift holding company. On January 1, 2006, Mr. Allio assumed the role of Chairman, as Mr. Vernon assumed the role of Vice-Chairman.

Raymond E. Heh, President and Chief Operating Officer of the bank, has more than 40 years of banking experience in Ohio and held various executive offices with Bank One Akron NA, over a period of 18 years, including service as Chairman, President and Chief Executive Officer.

Therese A. Liutkus, Chief Financial Officer of Central Federal and the bank, has more than 19 years of banking and banking-related experience. She served as Chief Financial Officer of First Place Financial Corp. in Warren, Ohio and its subsidiary, First Place Bank, for six years. She is a Certified Public Accountant.

R. Parker MacDonell, the bank's Regional President - Columbus, has more than 18 years of banking experience, including various positions at Bank One Columbus NA, most recently as a Senior Vice President.

Eloise L. Mackus, Senior Vice President, General Counsel and Secretary of Central Federal and the bank, has more than 15 years of banking and banking-related experience, including private practice as a banking lawyer with firms in Connecticut and Ohio.

Timothy M. O'Brien, Senior Vice President, Mortgage Operations, of the bank, has more than 11 years of banking and mortgage experience, including experience with DeepGreen Bank, Metropolitan Bank & Trust, and Mellon Mortgage Company.

William R. Reed, Senior Credit Manager of the bank, has more than 30 years of banking experience and served as Senior Vice President and Senior Credit Officer of FirstMerit Corp. in Akron for 19 years, where he was also a member of the Corporate Executive Committee.

**Corporate Information**

The mailing address of our principal executive offices is 2923 Smith Road, Fairlawn, Ohio 44333. Our general telephone number at that address is 330.666.7979. Our subsidiary, CFBank, has a website at [www.CFBankOnline.com](http://www.CFBankOnline.com). Information on that website is not part of this prospectus and is not incorporated into this prospectus by reference.



**Table of Contents**

**The Offering**

Securities Offered for Sale	2,000,000 shares of common stock
Shares of Common Stock Outstanding after the Offering (assuming the underwriter's over-allotment option is not exercised)	4,243,662 shares
Offering Price	\$7.00 per share
Market for the Common Stock	Our common stock is quoted on the Nasdaq <sup>®</sup> Capital Market under the symbol CFBK.
Dividend Policy	We pay a quarterly dividend of \$0.09 per share of common stock, and we intend to continue that practice. However, we reserve the right to change the amount of our dividend or suspend or end the payment of the dividend at any time.
Use of Proceeds	We intend to downstream a substantial portion of the proceeds to the bank, where they may be used for, among other things, expanding commercial lending operations. Proceeds retained by us may be used for general corporate purposes.
Purchases by Officers and Directors	Certain of our officers and directors have indicated an interest in purchasing an aggregate of approximately 100,000 shares in the offering.
Risk Factors	Investment in our common stock involves certain risks, including the risk of loss of principal. You should read the Risk Factors section beginning on page 6 before deciding to purchase our common stock.

**Table of Contents**

**RISK FACTORS**

You should consider carefully the following risk factors before deciding whether to invest in our common stock. Our business could be harmed by any of these risks. The trading price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. In assessing these risks you should also refer to the other information contained in this prospectus, including our financial statements and related notes.

**Risks Related to the Banking Industry**

***Changes in economic and political conditions could adversely affect our earnings, as our borrowers' ability to repay loans and the value of the collateral securing our loans decline.***

Our success depends, to a certain extent, upon economic and political conditions, local and national, as well as governmental monetary policies. Conditions such as inflation, recession, unemployment, changes in interest rates, money supply and other factors beyond our control may adversely affect our asset quality, deposit levels and loan demand and, therefore, our earnings. Because we have a significant amount of real estate loans, decreases in real estate values could adversely affect the value of property used as collateral. Adverse changes in the economy may also have a negative effect on the ability of our borrowers to make timely repayments of their loans, which would have an adverse impact on our earnings. In addition, substantially all of our loans are to individuals and businesses in Ohio. Consequently, any decline in the economy of this market area could have an adverse impact on our earnings.

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

Our earnings depend substantially on our interest rate spread, which is the difference between (i) the rates we earn on loans, securities and other earning assets and (ii) the interest rates we pay on deposits and other borrowings. These rates are highly sensitive to many factors beyond our control, including general economic conditions and the policies of various governmental and regulatory authorities. As market interest rates rise, we will have competitive pressures to increase the rates we pay on deposits, which will result in a decrease of our net interest income. For additional information, see Management's Discussion and Analysis of Financial Condition and Results of Operation at page 22.

***We operate in a highly regulated environment, and changes in laws and regulations to which we are subject may adversely affect our results of operations.***

The bank operates in a highly regulated environment and is subject to extensive regulation, supervision and examination by the Office of Thrift Supervision ( OTS ) and the Federal Deposit Insurance Corporation ( FDIC ). The laws and regulations to which we are subject are intended to protect our depositors, not our investors. Applicable laws and regulations may change, and there is no assurance that such changes will not adversely affect our business. As a holding company, we also are subject to regulation and oversight by the OTS. Such regulation and supervision govern the activities in which an institution and its holding companies may engage and are intended primarily for the protection of the bank and its depositors. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of an institution, the classification of assets by the institution and the adequacy of an institution's allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, or legislation, including changes in the regulations

**Table of Contents**

governing savings and loan holding companies, could have a material impact on the bank, the holding company and our operations.

**Risks Related to Our Business**

***We operate in an extremely competitive market, and our business will suffer if we are unable to compete effectively.***

In our market area, the bank encounters significant competition from other commercial banks, savings and loan associations, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds and other financial institutions. Many of the bank's competitors have substantially greater resources and lending limits than the bank and may offer services that we do not or cannot provide. Our profitability depends upon our continued ability to compete successfully in our market area.

***The loss of key members of our senior management team could adversely affect our business.***

We believe that our success depends largely on the efforts and abilities of our senior management. Their experience and industry contacts significantly benefit us. The competition for qualified personnel in the financial services industry is intense, and the loss of any of our key personnel or an inability to continue to attract, retain and motivate key personnel could adversely affect our business. We cannot assure you that we will be able to retain our existing key personnel or attract additional qualified personnel.

***We have opened new offices, and we have hired a number of experienced employees, which has reduced our profitability in the near term.***

We opened two new offices in Fairlawn and Columbus, Ohio in 2003 and we have increased our personnel and other costs in anticipation of growth. We may expand further by opening additional offices. The expense associated with building and staffing new offices has significantly increased our noninterest expense, with compensation and occupancy costs constituting the largest amount of increased costs. Losses have been incurred from the new offices as the expenses associated with them are largely fixed and are typically greater than the income earned as the offices builds up their customer base. There can be no assurance that our office expansion will result in increased earnings, or that it will result in increased earnings within a reasonable period of time. We expect that the success of our expansion strategy will depend largely on the ability of our staff to market the deposit and loan products offered at the offices.

***Our loan portfolio includes loans with a higher risk of loss, and our non-residential loan portfolio is not seasoned.***

We originate commercial mortgage loans, commercial loans, consumer loans, and residential mortgage loans primarily within our market area. Commercial mortgage, commercial, and consumer loans may expose a lender to greater credit risk than loans secured by residential real estate because the collateral securing these loans may not be sold as easily as residential real estate. These loans also have greater credit risk than residential real estate for the following reasons:

*Commercial Mortgage Loans.* Repayment is dependent upon income being generated in amounts sufficient to cover operating expenses and debt service.

*Commercial Loans.* Repayment is dependent upon the successful operation of the borrower's business.

**Table of Contents**

*Consumer Loans.* Consumer loans (such as personal lines of credit) are collateralized, if at all, with assets that may not provide an adequate source of payment of the loan due to depreciation, damage, or loss.

Prior to our new management team joining in 2003, we originated primarily one-to four-family residential loans. While we believe that we have adhered to sound underwriting procedures with regard to our commercial real estate, commercial and consumer loans, the portfolio has grown rapidly in the last two years. Typically, unseasoned portfolios exhibit a greater risk of loss.

***If our actual loan losses exceed our allowance for loan losses, our net income will decrease.***

Our loan customers may not repay their loans according to their terms, and the collateral securing the payment of these loans may be insufficient to pay any remaining loan balance. We may experience significant loan losses, which could have a material adverse effect on our operating results. We make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of our loans. Because we must use assumptions regarding individual loans and the economy, our current allowance for loan losses may not be sufficient to cover actual loan losses, and increases in the allowance may be necessary. We may need to significantly increase our provision for losses on loans if one or more of our larger loans or credit relationships becomes delinquent or if we continue to expand our commercial real estate and commercial lending. In addition, federal and state regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize loan charge-offs. Material additions to our allowance would materially decrease our net income. We cannot assure you that our monitoring procedures and policies will reduce certain lending risks or that our allowance for loan losses will be adequate to cover actual losses.

***If we foreclose on collateral property and own the underlying real estate, we may be subject to the increased costs associated with the ownership of real property, resulting in reduced revenues.***

We may have to foreclose on collateral property to protect our investment and may thereafter own and operate such property, in which case we will be exposed to the risks inherent in the ownership of real estate. The amount that we, as a mortgagee, may realize after a default is dependent upon factors outside of our control, including, but not limited to: (i) general or local economic conditions; (ii) neighborhood values; (iii) interest rates; (iv) real estate tax rates; (v) operating expenses of the mortgaged properties; (vi) supply of and demand for rental units or properties; (vii) ability to obtain and maintain adequate occupancy of the properties; (viii) zoning laws; (ix) governmental rules, regulations and fiscal policies; and (x) acts of God. Certain expenditures associated with the ownership of real estate, principally real estate taxes and maintenance costs, may adversely affect the income from the real estate. Therefore, the cost of operating a real property may exceed the rental income earned from such property, and we may have to advance funds in order to protect our investment, or we may be required to dispose of the real property at a loss. The foregoing expenditures and costs could adversely affect our ability to generate revenues, resulting in reduced levels of profitability.

***Environmental liability associated with commercial lending could have a material adverse effect on our business, financial condition and results of operations.***

In the course of our business, we may acquire, through foreclosure, commercial properties securing loans that are in default. There is a risk that hazardous substances could be discovered on those properties. In this event, we could be required to remove the substances from and remediate

**Table of Contents**

the properties at our cost and expense. The cost of removal and environmental remediation could be substantial. We may not have adequate remedies against the owners of the properties or other responsible parties and could find it difficult or impossible to sell the affected properties. These events could have a material adverse effect on our business, financial condition and operating results.

***If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results or prevent fraud, and, as a result, investors and depositors could lose confidence in our financial reporting, which could adversely affect our business, the trading price of our stock and our ability to attract additional deposits.***

Beginning with our annual report for the fiscal year ending December 31, 2007, we will have to include in our annual reports filed with the Securities and Exchange Commission (the Commission) a report of our management regarding internal control over financial reporting. As a result, we recently have begun to document and evaluate our internal control over financial reporting in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act) and Commission rules and regulations, which require an annual management report on our internal control over financial reporting, including, among other matters, management's assessment of the effectiveness of internal control over financial reporting and an attestation report by our independent auditors addressing these assessments. Accordingly, management has retained outside consultants to assist us in (i) assessing and documenting the adequacy of our internal control over financial reporting, (ii) improving control processes, where appropriate, and (iii) verifying through testing that controls are functioning as documented. If we fail to identify and correct any significant deficiencies in the design or operating effectiveness of our internal control over financial reporting or fail to prevent fraud, current and potential stockholders and depositors could lose confidence in our financial reporting, which could adversely affect our business, financial condition and results of operations, the trading price of our stock and our ability to attract additional deposits.

***A breach of information security could negatively affect our business.***

We depend on data processing, communication and information exchange on a variety of computing platforms and networks and over the internet. We cannot be certain all of our systems are entirely free from vulnerability to attack, despite safeguards we have installed. Additionally, we rely on a variety of third-party service providers for our data and communications needs. If information security is breached, information can be lost or misappropriated, resulting in financial loss or costs to us or damages to others. These costs or losses could materially exceed our amount of insurance coverage, if any, which would adversely affect our business.

**Risks Related to this Offering**

***The price of our common stock may be volatile, which may result in losses for investors.***

The market price for shares of our common stock has been volatile in the past, and several factors could cause the price to fluctuate substantially in the future. These factors include:

announcements of developments related to our business,

fluctuations in our results of operations,

sales of substantial amounts of our securities into the marketplace,

general conditions in our banking niche or the worldwide economy,

**Table of Contents**

a shortfall in revenues or earnings compared to securities analysts' expectations,

lack of an active trading market for the common stock,

changes in analysts' recommendations or projections, and

our announcement of new acquisitions or other projects.

The market price of our common stock may fluctuate significantly in the future, and these fluctuations may be unrelated to our performance. General market price declines or market volatility in the future could adversely affect the price of our common stock, and the current market price may not be indicative of future market prices.

***Management has discretionary use of the proceeds from this offering, and you may not agree with the uses we choose to make of the offering proceeds.***

Management will have broad discretion to use the net proceeds we receive from this offering for general corporate purposes. We have not specified uses of the net proceeds. All determinations concerning the use of the net proceeds will be made by our management. Accordingly, there is a greater degree of uncertainty concerning the return on any investments we may make, than would be the case if specific investments were identified, and there is no assurance that you will agree with the uses we choose to make of these net proceeds.

***Our return on equity is low compared to other companies. This could hurt the price of our common stock.***

Net earnings divided by average equity, known as return on equity, is a ratio many investors use to compare the performance of a financial institution to its peers. Our return on average equity amounted to -8.60% and -12.34% in 2004 and 2003 respectively. Our return on average equity amounted to -18.22% for the nine months ended September 30, 2005. Moreover, we have experienced net losses of \$2,627,000, \$1,662,000 and \$2,374,000 for the nine months ended September 30, 2005, and the years ended December 31, 2004 and 2003, respectively. We expect our return on equity to remain low as we attempt to increase net earnings and due to the increased equity from the offering. Until we can increase our net interest income and other income, we expect our return on equity to be below the industry average, which may negatively impact the value of our stock.

***Our common stock is thinly traded, and thus your ability to sell shares or purchase additional shares of our common stock will be limited, and the market price at any time may not reflect true value.***

Your ability to sell shares of our common stock or purchase additional shares largely depends upon the existence of an active market for the common stock. Our common stock is quoted on the Nasdaq<sup>®</sup> Capital Market, but the volume of trades on any given day is light, and you may be unable to find a buyer for shares you wish to sell or a seller of additional shares you wish to purchase. We cannot assure you that an active trading market for our common stock will develop, or if it develops, that it will continue. In addition, a fair valuation of the purchase or sales price of a share of common stock also depends upon active trading, and thus the price you receive for a thinly traded stock, such as our common stock, may not reflect its true value.

**Table of Contents**

***Future sales or additional issuances of our capital stock may depress prices of shares of our common stock or otherwise dilute the book value of shares then outstanding.***

Sales of a substantial amount of our capital stock in the public market or the issuance of a significant number of shares could adversely affect the market price for shares of our common stock. As of September 30, 2005, we were authorized to issue up to 6,000,000 shares of common stock, of which 2,243,662 shares were outstanding, 300,872 shares were reserved for issuance pursuant to options granted under our stock option plans and an additional 10,000 shares were available for granting options or shares of restricted stock under these plans. We also were authorized to issue up to 1,000,000 shares of preferred stock, none of which is outstanding or reserved for issuance. Accordingly, without further stockholder approval, we may issue up to 3,445,466 additional shares of common stock and up to 1,000,000 shares of preferred stock, which obviously may affect the market price for shares of our common stock.

***Our charter documents, Delaware law and federal regulations may inhibit a takeover, prevent a transaction you may favor or limit our growth opportunities, which could cause the market price of our common stock to decline.***

Certain provisions of our charter documents, Delaware law and federal regulations could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from attempting to acquire, control of our company. In addition, we must obtain approval from the OTS before acquiring control of any other company.

***We may not be able to pay dividends in the future in accordance with past practice.***

We pay a quarterly dividend to stockholders. However, we are dependent primarily upon the bank for our earnings and funds to pay dividends on our common stock. The payment of dividends also is subject to legal and regulatory restrictions. Any payment of dividends in the future will depend, in large part, on the bank's earnings, capital requirements, financial condition and other factors considered relevant by our Board of Directors (the Board).

**Table of Contents**

**FORWARD-LOOKING STATEMENTS**

This prospectus contains forward-looking statements which may be identified by the use of such words as may, believe, expect, anticipate, should, plan, estimate, predict, continue, and potential or the negative of other comparable terminology. Examples of forward-looking statements include, but are not limited to, estimates with respect to our financial condition, results of operations and business that are subject to various factors which could cause actual results to differ materially from these estimates. These factors include, but are not limited to (i) general and local economic conditions, (ii) changes in interest rates, deposit flows, demand for mortgages and other loans, real estate values, and competition, (iii) changes in accounting principles, policies, or guidelines, (iv) changes in legislation or regulation; and (v) other economic, competitive, governmental, regulatory, and technological factors affecting our operations, pricing, products, and services.

Any or all of our forward-looking statements in this prospectus and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Consequently, no forward-looking statement can be guaranteed. We do not intend to update any of the forward-looking statements after the date of this prospectus or to conform these statements to actual results.



**Table of Contents****USE OF PROCEEDS**

We anticipate that our net proceeds from the sale of our common stock in this offering, assuming the underwriter does not exercise its option to cover over-allotments, will be approximately \$12.6 million, after deducting offering expenses and underwriting commissions, estimated to be \$1.4 million.

We intend to use the net proceeds for general corporate purposes. A substantial portion of the proceeds will be downstreamed to the bank. We also may expand our commercial lending operations. Although we may explore acquisitions, we are not presently engaged in any negotiations, and we have no specific acquisition plans or objectives. Management has not yet determined the amount of proceeds to be used for each purpose, or the priority of purposes. Pending use of proceeds for these purposes, it is likely they will be invested in short-term investment securities.

	<b>2,000,000 Shares</b>	
	<b>Amount</b>	<b>Percent of Net Proceeds</b>
	<b>(In thousands)</b>	
Gross offering proceeds	\$ 14,000	
Less:		
Underwriting commissions	980	
Total estimated offering expenses	450	
Net offering proceeds	12,570	100.0%
Less:		
Proceeds contributed to CFBank <sup>1</sup>	10,056	80.0%
Proceeds retained by Central Federal Corporation <sup>2</sup>	\$ 2,514	20.0%

<sup>1</sup> Proceeds contributed to CFBank may be used for, among other things, expanding commercial lending operations.

<sup>2</sup> Proceeds retained by Central Federal Corporation may be used for general corporate purposes.

**Table of Contents****MARKET FOR OUR COMMON STOCK AND DIVIDENDS**

*Market Information and Dividends.* Our common stock is quoted on the Nasdaq<sup>®</sup> Capital Market under the symbol CFBK. At September 30, 2005, there were 2,243,662 shares of common stock outstanding and approximately 568 holders of record. The last reported sales price of our common stock on January 10, 2006 was \$7.75 per share. The table below shows the high and low sales prices per share for our common stock by calendar quarter for the years indicated and the dividend paid in each quarter.

	<b>High</b>	<b>Low</b>	<b>Dividend</b>
<b>2005</b>			
Fourth Quarter	\$ 9.45	\$ 7.07	\$ 0.09
Third Quarter	10.49	8.07	0.09
Second Quarter	10.99	9.53	0.09
First Quarter	13.72	10.15	0.09
<b>2004</b>			
Fourth Quarter	\$ 13.73	\$ 10.95	\$ 0.09
Third Quarter	15.22	11.25	0.09
Second Quarter	18.00	12.35	0.09
First Quarter	16.10	12.00	0.09
<b>2003</b>			
Fourth Quarter	\$ 16.18	\$ 13.60	\$ 0.09
Third Quarter	14.00	10.70	0.09
Second Quarter	13.13	10.49	0.09
First Quarter	11.03	9.28	0.09

Holders of our common stock are entitled to receive cash dividends when and if declared by the Board from funds legally available for that purpose. Our ability to pay cash dividends is limited to an amount equal to the surplus (*i.e.*, the excess of our net assets over paid-in-capital) or, if there is no surplus, our net earnings for the current and/or immediately preceding fiscal year. The primary source of funds for any cash dividends payable to our stockholders would be the dividends received from CFBank. The payment of cash dividends by the bank is determined by the Board (which also constitutes the bank's board of directors) and is dependent upon a number of factors, including the bank's capital requirements, applicable regulatory limitations, results of operations and financial condition. See

Regulation and Supervision and Description of Our Common Stock for a description of the restrictions on our payment of dividends under federal banking laws and the Delaware General Corporation Law.

**Table of Contents**

*Equity Compensation Plan Information.* The following table sets forth information about the common stock that may be issued upon exercise of options, warrants and rights under all of our equity compensation plans as of September 30, 2005.

<b>Plan Category</b>	<b>Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights</b>	<b>Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights</b>	<b>Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans</b>
Equity compensation plans approved by shareholders	300,872	\$ 11.33	10,000
Equity compensation plans not approved by shareholders			
<b>Total</b>	<b>300,872</b>	<b>\$ 11.33</b>	<b>10,000</b>

**Table of Contents****CAPITALIZATION**

The following table sets forth our consolidated capitalization as of September 30, 2005 on an actual basis and on a *pro forma* basis to give effect to the shares to be issued in this offering. We have assumed that the net offering proceeds will be \$12.6 million, after deducting estimated offering expenses and underwriting commissions of approximately \$1.4 million, and assuming no exercise of the underwriter's over-allotment option. You should read this information together with our consolidated financial statements and related notes, which are included in this prospectus.

**Pro Forma Consolidated Capitalization (unaudited)**

	<b>At September 30, 2005</b>		
	<b>Actual</b>	<b>Pro Forma Adjustments</b>	<b>Pro Forma</b>
	<b>(Dollars in thousands)</b>		
<b>Long term debt:</b>			
Subordinated debentures	\$ 5,155		\$ 5,155
<b>Total indebtedness</b>	<b>5,155</b>		<b>5,155</b>
<b>Shareholders' equity:</b>			
Preferred stock, 1,000,000 shares authorized, none issued			
Common stock, \$.01 par value, 6,000,000 shares authorized:			
2,312,195 shares issued before the offering			
(4,312,195 shares pro forma)(1)	23	20	43
Additional paid-in capital(1)	12,801	12,550	25,351
Retained earnings	5,179		5,179
Accumulated other comprehensive income	316		316
Unearned stock based incentive plan shares	(354)		(354)
Treasury stock, at cost, 68,533 shares	(783)		(783)
<b>Total shareholders' equity</b>	<b>17,182</b>	<b>12,570</b>	<b>29,752</b>
<b>Total capitalization</b>	<b>\$ 22,337</b>	<b>\$ 12,570</b>	<b>\$ 34,907</b>

(1) Assumes the sale of 2,000,000 shares of common stock in this offering, generating net proceeds of \$12.6 million after deducting offering expenses.

**Table of Contents****SELECTED CONSOLIDATED FINANCIAL INFORMATION**

The information in the following table should be read in conjunction with our consolidated financial statements, the related notes and Management's Discussion and Analysis of Financial Condition and Results of Operations, as contained in this prospectus.

The information as of and for the nine months ended September 30, 2005 and 2004 is unaudited, but, in the opinion of management, this information is accurate and contains all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of our financial condition and results of operations for those periods. The results of operations for the nine-month period ended September 30, 2005 are not necessarily indicative of the results to be expected for the final quarter of 2005 or for any other period.

	<b>At December 31,</b>					
<b>At September 30, 2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	
<b>(Unaudited)</b>						
	<b>(Dollars in thousands)</b>					
<b>Selected Financial Condition Data:</b>						
Total assets	\$ 157,853	\$ 171,005	\$ 107,011	\$ 110,551	\$ 120,927	\$ 140,933
Cash and cash equivalents	2,335	32,675	8,936	12,861	4,329	2,930
Securities available for sale	33,321	13,508	27,126	1,439	2,092	3,090
Securities held to maturity				17,822	23,343	35,796
Loans, net(1)	106,999	108,149	58,024	62,565	70,570	86,265
Goodwill		1,749				
Other intangible assets		299				
Deposits	120,745	101,624	73,358	74,690	76,168	73,997
FHLB advances	13,945	41,170	7,500	11,430	18,393	40,536
Other borrowings		2,249		4,900	7,000	7,000
Subordinated debentures	5,155	5,155	5,155			
Total shareholders equity	17,182	19,507	19,856	17,583	18,160	17,833

	<b>For the Nine Months Ended September 30,</b>		<b>For the Year Ended December 31,</b>				
	<b>2005</b>	<b>2004</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
	<b>(Unaudited)</b>		<b>(Dollars in thousands)</b>				
<b>Summary of Earnings:</b>							
Total interest income	\$ 6,223	\$ 4,260	\$ 6,144	\$ 5,435	\$ 7,067	\$ 9,588	\$ 9,834
Total interest expense	2,585	1,405	2,149	3,521	3,462	5,299	5,802
Net interest income	3,638	2,855	3,995	1,914	3,605	4,289	4,032

Edgar Filing: CENTRAL FEDERAL CORP - Form 424B1

Provision for loan losses	402	366	646	102	19	62	
Net interest income after provision for loan losses	3,236	2,489	3,349	1,812	3,586	4,227	4,032
Noninterest income							
Net gain (loss) on sale of securities		(55)	(55)	42	16	15	10
Other	673	337	592	714	549	169	284
Total noninterest income	673	282	537	756	565	184	294
Impairment loss on goodwill and intangibles	1,966						
Noninterest expense	5,117	4,671	6,420	5,930	3,164	3,501	3,900
Total noninterest expense	7,083	4,671	6,420	5,930	3,164	3,501	3,900
Income (loss) before income taxes	(3,174)	(1,900)	(2,534)	(3,362)	987	910	426
Income tax expense (benefit)	(547)	(683)	(872)	(988)	313	312	150
Net income (loss)	\$ (2,627)	\$ (1,217)	\$ (1,662)	\$ (2,374)	\$ 674	\$ 598	\$ 276

(See footnotes on page 19)

**Table of Contents**

	<b>At or For the Nine Months Ended September 30,</b>		<b>At or For the Year Ended December 31,</b>				
	<b>2005(2)</b>	<b>2004</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
<b>(Unaudited)</b>							
<b>Selected Financial Ratios and Other Data:</b>							
<b>Performance Ratios:(3)</b>							
Return on average assets	(2.19)%	(1.30)%	(1.23)%	(2.19)%	0.58%	0.45%	0.02%
Return on average equity	(18.22)%	(8.48)%	(8.60)%	(12.34)%	3.76%	3.32%	1.27%
Average yield on interest-earning assets(4)	5.78%	5.04%	5.03%	5.62%	6.98%	7.71%	7.42%
Average rate paid on interest-bearing liabilities	2.60%	1.84%	1.93%	2.63%	3.63%	4.65%	5.01%
Average interest rate spread(5)	3.18%	3.20%	3.10%	2.99%	3.35%	3.06%	2.21%
Net interest margin, fully taxable equivalent(6)(7)	3.38%	3.38%	3.27%	3.28%	3.56%	3.45%	2.96%
Interest-earning assets to interest-bearing liabilities	108.4%	110.9%	109.8%	113.4%	106.1%	109.2%	120.2%
Efficiency ratio(8)	164.3%	146.3%	140.0%	225.7%	76.2%	78.5%	90.4%
Noninterest expense to average assets	5.9%	5.0%	4.7%	5.5%	2.7%	2.6%	2.8%
Dividend payout ratio	n/m	n/m	n/m	n/m	83.7%	81.6%	n/m
<b>Capital Ratios:(2)</b>							
Equity to total assets at end of period	10.88%	12.39%	11.41%	18.56%	15.90%	15.02%	12.65%
Average equity to average assets	12.02%	15.30%	14.26%	17.76%	15.54%	13.54%	15.68%
Tangible capital ratio(9)	7.82%	9.51%	8.10%	13.90%	18.90%	18.40%	15.60%
Core capital ratio(9)	7.82%	9.51%	8.10%	13.90%	18.90%	18.40%	15.60%
Risk-based capital ratio(9)	11.48%	14.55%	12.20%	21.60%	38.60%	35.70%	32.40%
<b>Asset Quality Ratios:(2)</b>							
Nonperforming loans to total loans(10)	0.56%	0.17%	0.26%	1.28%	1.25%	1.25%	0.56%
Nonperforming assets to total assets(11)	0.40%	0.56%	0.24%	0.87%	0.71%	0.81%	0.35%
Allowance for loan losses to total loans	1.13%	0.77%	0.90%	0.71%	0.57%	0.53%	0.41%
Allowance for loan losses to nonperforming loans(10)	202.2%	451.6%	342.0%	56.0%	46.2%	42.2%	72.4%
Net charge-offs to average loans	0.18%	0.06%	0.10%	0.08%	0.05%	0.05%	0.02%
<b>Per Share Data:</b>							
Basic earnings (loss) per share	\$ (1.19)	\$ (0.61)	\$ (0.82)	\$ (1.31)	\$ 0.44	\$ 0.38	\$ 0.17

Diluted earnings (loss) per share	(1.19)	(0.61)	(0.82)	(1.31)	0.43	0.38	0.17
Dividends declared(12)	0.27	0.27	0.36	0.36	0.36	0.31	6.25
Tangible book value per share at end of period	7.66	8.92	7.99	9.81	10.68	10.42	10.19

*(See footnotes on page 19)*



**Table of Contents**

- (1) Loans, net represents gross loans receivable net of the allowance for loan losses, loans in process and deferred loan origination fees.
- (2) Performance ratios for the nine months ended September 30, 2005 were significantly affected by the pre-tax \$2.0 million impairment loss on goodwill and intangibles

Following are performance ratios excluding this charge:

Return on average assets	(0.61)%
Return on average equity	(5.04)%
Efficiency ratio	118.7%
Ratio of noninterest expense to average assets	4.3%
Reconciliation of GAAP net loss to loss excluding the impairment loss on goodwill and intangibles	
GAAP net loss	\$ (2,627)
Impairment loss on goodwill and intangibles net of tax	1,893
Loss excluding impairment loss on goodwill and intangibles	\$ (734)

- (3) Asset quality ratios and capital ratios are end-of-period ratios. All other ratios are based on average monthly balances during the indicated periods.
- (4) Calculations of yield are presented on a taxable equivalent basis using the federal income tax rate of 34%.
- (5) The average interest rate spread represents the difference between the weighted average yield on average interest-earning assets and the weighted average cost of average interest-bearing liabilities.
- (6) The net interest margin represents net interest income as a percent of average interest-earning assets.
- (7) Calculated excluding the \$1.3 million penalty on payment of FHLB advances in 2003
- (8) The efficiency ratio equals noninterest expense divided by net interest income plus noninterest income (excluding gains or losses on securities transactions).
- (9) Regulatory capital ratios of CFBank.
- (10) Nonperforming loans consist of nonaccrual loans and other loans 90 days or more past due.
- (11) Nonperforming assets consist of nonperforming loans, other repossessed assets and REO.
- (12) We paid a return of capital dividend of \$6.00 per share in 2000.  
n/m not meaningful

**Table of Contents**

**SUPPLEMENTARY CONSOLIDATED FINANCIAL INFORMATION**  
**Central Federal Corporation**  
**Selected Quarterly Financial Data**  
**(unaudited)**

	March 31	June 30	September 30	December 31
<b>2005</b>				
Total interest income	\$ 1,938	\$ 2,098	\$ 2,187	
Total interest expense	769	856	960	
Net interest income	1,169	1,242	1,227	
Provision for loan losses	218	134	50	
Net interest income after provision for loan losses	951	1,108	1,177	
Total noninterest income	299	213	161	
Impairment loss on goodwill and intangibles(1)			1,966	
Total noninterest expense	1,702	1,738	1,677	
Loss before income tax	(452)	(417)	(2,305)	
Income tax benefit	(163)	(147)	(237)	
Net loss	\$ (289)	\$ (270)	\$ (2,068)	
Basic loss per share	\$ (0.13)	\$ (0.12)	\$ (0.94)	
Diluted loss per share	\$ (0.13)	\$ (0.12)	\$ (0.94)	
<b>2004</b>				
Total interest income	\$ 1,271	\$ 1,372	\$ 1,617	\$ 1,884
Total interest expense	400	441	564	744
Net interest income	871	931	1,053	1,140
Provision for loan losses	36	34	296	280
Net interest income after provision for loan losses	835	897	757	860
Total noninterest income	92	134	56	255
Total noninterest expense	1,355	1,483	1,833	1,749
Loss before income tax	(428)	(452)	(1,020)	(634)
Income tax benefit	(160)	(168)	(355)	(189)
Net loss	\$ (268)	\$ (284)	\$ (665)	\$ (445)
Basic loss per share	\$ (0.13)	\$ (0.14)	\$ (0.33)	\$ (0.21)
Diluted loss per share	\$ (0.13)	\$ (0.14)	\$ (0.33)	\$ (0.21)



**Table of Contents**

	March 31	June 30	September 30	December 31
<b>2003</b>				
Total interest income	\$ 1,488	\$ 1,355	\$ 1,425	\$ 1,167
Total interest expense(2)	601	516	612	1,792
Net interest income	887	839	813	(625)
Provision for loan losses		83		19
Net interest income after provision for loan losses	887	756	813	(644)
Total noninterest income	171	211	234	140
Total noninterest expense(3)	2,770	675	1,129	1,356
Income before income tax	(1,712)	292	(82)	(1,860)
Income tax expense (benefit)	(589)	240	(48)	(591)
Net income (loss)	\$ (1,123)	\$ 52	\$ (34)	\$ (1,269)
Basic earnings (loss) per share	\$ (0.74)	\$ 0.03	\$ (0.02)	\$ (0.64)
Diluted earnings (loss) per share	\$ (0.74)	\$ 0.03	\$ (0.02)	\$ (0.64)

- (1) The quarter ended September 30, 2005 includes \$2.0 million pre-tax impairment loss on goodwill and intangibles.
- (2) Interest expense during the quarter ended December 31, 2003 included a \$1.3 million penalty on prepayment of FHLB advances.
- (3) Noninterest expense during the quarter ended March 31, 2003 included \$1.8 million in salaries and benefits expense related to restructuring of employee benefit plans and payments on agreements with former executives.

**Table of Contents**

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

**General**

Central Federal Corporation (formerly known as Grand Central Financial Corp.) was formed as a savings and loan holding company as a result of the conversion of CFBank (formerly known as Central Federal Savings and Loan Association of Wellsville and, more recently as Central Federal Bank) from a federally-chartered mutual savings and loan association to a federally-chartered stock savings and loan association in December of 1998.

We are a community-oriented financial institution offering a variety of financial services to meet the needs of the communities it serves. We attract deposits from the general public and use such deposits, together with borrowings and other funds, primarily to originate commercial and commercial real estate loans, single-family and multi-family residential mortgage loans and home equity lines of credit.

Our results of operations are dependent primarily on net interest income, which is the difference ( spread ) between the interest income earned on loans and securities and the cost of funds, consisting of interest paid on deposits and borrowed funds. The interest rate spread is affected by regulatory, economic and competitive factors that influence interest rates, loan demand and deposit flows. Our net income is also affected by, among other things, loan fee income, provisions for loan losses, service charges, gains on loan sales, operating expenses and franchise and income taxes. Our operating expenses principally consist of employee compensation and benefits, occupancy and other general and administrative expenses. Our results of operations are significantly affected by general economic and competitive conditions, particularly changes in market interest rates, government policies and actions of regulatory authorities. Future changes in applicable laws, regulations or government policies may also materially impact us.

**Critical Accounting Policies**

We follow financial accounting and reporting policies that are in accordance with generally accepted accounting principles in the United States of America and conform to general practices within the banking industry. These policies are presented in Note 1 to our audited consolidated financial statements. Some of these accounting policies are considered to be critical accounting policies, which are those policies that require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Application of assumptions different than those used by management could result in material changes in our financial position or results of operations. Management believes that the judgments, estimates and assumptions used in the preparation of the consolidated financial statements are appropriate given the factual circumstances at the time.

We have identified accounting policies that are critical accounting policies and an understanding of these policies is necessary to understand our financial statements. One critical accounting policy relates to determining the adequacy of the allowance for loan losses. Our Allowance for Loan Losses Policy provides a thorough, disciplined and consistently applied process that incorporates management's current judgments about the credit quality of the loan portfolio into determination of the allowance for loan losses in accordance with generally accepted accounting principles and supervisory guidance. 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. Management believes that

**Table of Contents**

an adequate allowance for loan losses has been established. Additional information regarding this policy is included in the section below captioned *Provision for Loan Losses* and in Notes 1 and 4 to our audited consolidated financial statements.

Another critical accounting policy relates to the valuation of the deferred tax asset for net operating losses. Net operating losses totaling \$2.8 million and \$2.5 million expire in 2023 and 2024, respectively. No valuation allowance has been recorded against the deferred tax asset for net operating losses because the benefit is more likely than not to be realized. As we continue our strategy to expand into business financial services and focus on growth, the resultant increase in interest-earning assets is expected to increase profitability. Additional information is included in Notes 1 and 14 to our audited consolidated financial statements.

Another critical accounting policy relates to the valuation of goodwill and the assessment of impairment. Goodwill is not subject to amortization and is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Goodwill totaling \$1.7 million resulted from the acquisition of Reserve Mortgage Services, Inc. ( *Reserve* ) in 2004 and represented the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. We expected Reserve's performance to be accretive to earnings, but lower than projected loan origination and sales volumes have resulted in losses. Management does not believe that volumes will achieve a sufficient level to support the recorded goodwill. As a result, we recorded non-cash after-tax impairment loss of \$1.9 million or \$.86 per diluted share in the quarter ended September 30, 2005 to write-off the \$1.7 million value of goodwill and \$217,000 in other intangible assets related to the October 2004 acquisition. The decision to recognize the impairment loss was in accordance with Statement of Financial Accounting Standards ( *SFAS* ) No. 142, *Goodwill and Other Intangible Assets* which requires recognition of an impairment loss when the carrying amount of the asset is not recoverable and its carrying amount exceeds its fair value. Additional information is included in Notes 1, 2 and 7 to our audited consolidated financial statements.

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

*General.* Total assets at December 31, 2004 included \$30.0 million in overnight investments at a positive spread to the FHLB advances used to fund the investment. As short term interest rates increased and the spread between the investment and borrowing declined, the cash was withdrawn to repay the advances during the first quarter of 2005. The \$13.1 million decline in total assets to \$157.9 million at September 30, 2005 from \$171.0 million at December 31, 2004 was the result of the \$30.0 million reduction in cash and borrowings associated with the arbitrage transaction and the \$2.0 million pre-tax impairment charge discussed above, offset by \$12.2 million growth in commercial loans and \$8.0 million growth in home equity lines of credit. Loan growth was funded by \$19.1 million in deposit growth.

*Cash and cash equivalents.* Cash and cash equivalents totaled \$2.3 million at September 30, 2005, a decline of \$30.4 million from \$32.7 million at December 31, 2004 due to the use of cash to repay FHLB advances as discussed above.

*Securities.* Securities available for sale totaled \$33.3 million at September 30, 2005, an increase of \$19.8 million from \$13.5 million at December 31, 2004 due to a securitization transaction, discussed below.

*Loans.* Loans totaled \$107.0 million at September 30, 2005 compared to \$108.1 million at December 31, 2004. Single-family residential loan balances declined \$19.2 million and totaled \$23.4 million at September 30, 2005 due to the securitization discussed below. Not considering the

**Table of Contents**

securitization transaction, overall loan balances increased 16.1%. Commercial loan balances, which include multi-family and commercial real estate loans, increased \$12.2 million and totaled \$64.9 million at September 30, 2005 compared to \$52.7 million at December 31, 2004 as we continued to focus on these lending types as part of its strategic growth plan. Total consumer loan balances increased \$6.2 million due to \$8.0 million growth in home equity lines of credit offset by a \$2.1 million decline in auto loan balances.

In a transaction with Freddie Mac in the second quarter of 2005, we securitized single-family residential mortgage loans held in its portfolio with an outstanding principal balance of \$18.6 million. The securitization increased liquidity as the securities retained are readily marketable, eliminated credit risk on the loans and reduced the bank's risk-based capital requirement.

*Deposits.* Deposits increased \$19.1 million or 18.8% during the first nine months of 2005 and totaled \$120.7 million at September 30, 2005 compared to \$101.6 million at December 31, 2004. The increase was due to growth of \$17.7 million in certificate of deposit accounts and \$4.5 million in demand deposit accounts, largely checking accounts. Traditional savings account balances declined \$3.1 million.

*Federal Home Loan Bank Advances.* FHLB advances totaled \$13.9 million at September 30, 2005, a decline of \$27.3 million from \$41.2 million at December 31, 2004 due to repayment of borrowings associated with the arbitrage transaction, discussed above.

*Other Borrowings.* Other borrowings, which totaled \$2.2 million at December 31, 2004 and represented the outstanding balance on a revolving line of credit with an unaffiliated bank acquired in the Reserve acquisition, were repaid during the quarter ended March 31, 2005.

*Shareholders' Equity.* Total shareholders' equity declined \$2.3 million during the first nine months of 2005 and totaled \$17.2 million at September 30, 2005 compared to \$19.5 million at December 31, 2004 due to the net loss and dividends during the period. The decline was offset by the \$350,000 after tax unrealized gain on the securities retained in the securitization and \$375,000 in proceeds from the exercise of stock options. Our capital ratio was 10.9% at September 30, 2005 compared to 11.4% at December 31, 2004.

OTS regulations require savings institutions to maintain certain minimum levels of regulatory capital. Additionally, the regulations establish a framework for the classification of savings institutions into five categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Generally, an institution is considered well-capitalized if it has a core (Tier 1) capital ratio of at least 5.0% (based on adjusted total assets); a core (Tier 1) risk-based capital ratio of at least 6.0%; and a total risk-based capital ratio of at least 10.0%. Continued operating losses may require us to infuse additional capital into the bank.

**Comparison of Financial Condition at December 31, 2004 and December 31, 2003**

*General.* Total assets increased \$64.0 million, or 59.8% during 2004 and totaled \$171.0 million at December 31, 2004 compared to \$107.0 million at December 31, 2003 primarily due to growth in the commercial and multi-family loan portfolios and short term cash balances.

*Cash and Cash Equivalents.* Cash and cash equivalents totaled \$32.7 million at December 31, 2004, an increase of \$23.8 million from \$8.9 million at December 31, 2003. The increase was primarily in funds from overnight borrowings, which were invested in short term cash investments available to fund loans.

**Table of Contents**

*Securities.* Securities available for sale declined \$13.6 million during the year and totaled \$13.5 million at December 31, 2004 compared to \$27.1 million at December 31, 2003. Cash flows from maturities and sales were generally invested in short term cash investments in anticipation of commercial loan growth.

*Loans.* Loans, net increased \$50.1 million, or 86.4% during 2004 and totaled \$108.1 million at December 31, 2004 compared to \$58.0 million at December 31, 2003 primarily due to growth in commercial, commercial real estate and multi-family mortgage loans and, to a lesser extent, growth in single-family mortgage loan balances. Commercial, commercial real estate and multi-family mortgage loan balances increased \$42.3 million and totaled \$52.7 million at December 31, 2004 compared to \$10.4 million at December 31, 2003 as we continued to focus on business banking. Single-family mortgage loan balances increased \$6.6 million during the year and totaled \$41.4 million at December 31, 2004 compared to \$34.8 million at December 31, 2003.

*Deposits.* Deposits increased \$28.2 million, or 38.4% during 2004 and totaled \$101.6 million at December 31, 2004 compared to \$73.4 million at December 31, 2003. The increase was due to growth of \$14.6 million in money market accounts, \$9.6 million in certificate of deposit accounts and \$4.4 million in checking accounts, primarily commercial checking accounts offset by a \$383,000 decline in savings accounts. The growth in deposits was primarily the result of our focus on commercial customer relationships and our expansion into new markets. The growth in certificate of deposit accounts included \$6.1 million in brokered deposits. We expect to continue to use brokered deposits as a source of funding depending on market conditions, pricing and funding needs.

*Federal Home Loan Bank Advances.* FHLB advances increased \$33.7 million during 2004 and totaled \$41.2 million at December 31, 2004 compared to \$7.5 million at December 31, 2003 as advances were used to fund loan growth and short term cash investments. Fixed rate advances for terms of one through 4.5 years totaling \$12.3 million were drawn primarily during the first six months of 2004 to fund loans at low borrowing interest rates and protect our interest rate risk position as market interest rates increased.

*Other Borrowings.* Other borrowings totaled \$2.2 million at December 31, 2004 and represent the outstanding balance on a revolving line of credit with an unaffiliated bank, acquired in the Reserve acquisition. There were no other borrowings at December 31, 2003.

*Subordinated Debentures.* Subordinated debentures totaled \$5.2 million at year-end 2004 and 2003 and were issued by us in 2003 in exchange for the proceeds of a \$5.0 million trust preferred securities offering issued by a trust formed by us. The proceeds of the offering are available to provide capital for CFBank to support growth.

*Shareholders Equity.* Total shareholders equity declined 1.8% during 2004 and totaled \$19.5 million at December 31, 2004 compared to \$19.9 million at December 31, 2003 primarily due to the net loss and dividends during the year offset by the issuance of additional capital in the acquisition of Reserve in October 2004. Capital levels remained strong as we continued to leverage our capital through growth. Our capital ratio totaled 11.4% at December 31, 2004 compared to 18.6% at December 31, 2003. OTS regulations require savings institutions to maintain certain minimum levels of regulatory capital, described above. The bank had capital ratios above the well-capitalized levels at December 31, 2004 and 2003.



**Table of Contents****Comparison of Results of Operations for the Three Months Ended September 30, 2005 and 2004**

*General.* We incurred a net loss for the quarter ended September 30, 2005 of \$2.1 million or \$.94 per diluted share compared to a net loss of \$665,000 or \$.33 per diluted share for the quarter ended September 30, 2004. The current year quarter included a \$1.9 million, or \$0.86 per diluted share impairment loss discussed above. Not including the impairment loss, the current year quarter loss totaled \$175,000 or \$.08 per diluted share, a 74% improvement from the prior year period. The current period loss (excluding the impairment loss) was due to \$57,000 net operating losses of the bank's mortgage services division, the expense associated with increasing the reserve for loan losses and operating costs necessary to support Company's growth plan. Profitability during the first nine months of 2005 has been negatively impacted by Reserve's pretax operating losses. We expected Reserve's performance to be accretive to earnings, but lower than projected loan origination and sales volumes have resulted in losses. We recorded a non-cash after-tax impairment loss of \$1.9 million or \$0.86 per diluted share in the quarter ended September 30, 2005 to write-off the value of goodwill and other intangible assets related to the October 2004 acquisition. Goodwill totaling \$1.7 million represented the excess of the purchase price over the fair value of acquired tangible assets and liabilities and identifiable intangible assets. Other intangible assets with an unamortized balance of \$217,000 consisted of prior owner intangibles arising from the acquisition. The decision to recognize the impairment loss was in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* which requires recognition of an impairment loss when the carrying amount of the asset is not recoverable and its carrying amount exceeds its fair value. Recognition of the impairment loss had no effect on the regulatory capital ratios of CFBank or our tangible book value.

*Net Interest Income.* Net interest income increased 16.5% to \$1.2 million for the quarter ended September 30, 2005 from \$1.1 million in the prior year quarter due to growth in assets in accordance with our growth plan. Both the volume and yield on interest-earning assets increased in the third quarter of 2005 compared to the prior year quarter. The resultant growth in interest income was partially offset by increased interest expense related to funding loan growth due to an increase in volume and cost of interest-bearing liabilities during the current year quarter.

Average interest earning assets increased \$14.1 million or 11.0% to \$142.8 million in the third quarter of 2005 from \$128.7 million in the third quarter of 2004 due to loan growth pursuant to our strategy to expand into business banking in the Fairlawn and Columbus, Ohio markets. The yield on interest earning assets increased 112 basis points to 6.15% in the third quarter of 2005 from 5.03% in the prior year quarter reflecting higher yields on commercial, commercial real estate and multi-family loans. Interest income increased \$570,000 or 35.3% to \$2.2 million in the third quarter of 2005 from \$1.6 million in the prior year quarter due to growth in interest income on loans, which increased \$437,000 or 34.0% to \$1.7 million for the quarter ended September 30, 2005 from \$1.3 million in the prior year quarter. Average loan balances increased \$16.2 million, or 18.1% to \$105.6 million in the third quarter of 2005 from \$89.4 million in the prior year quarter and the average yield on loans increased 77 basis points to 6.53% in the third quarter of 2005 from 5.76% in the prior year quarter due to commercial, commercial real estate and multi-family mortgage loan growth and an increase in yields on home equity lines of credit caused by the increase in short-term market interest rates and the resultant increase in the prime rate.

Average interest-bearing liabilities increased \$14.5 million or 12.3% to \$132.4 million in the third quarter of 2005 from \$117.9 million in the third quarter of 2004 due to growth in deposits used to fund loan growth. The average cost of interest-bearing liabilities increased 99 basis points or

**Table of Contents**

51.8% to 2.90% in the third quarter of 2005 from 1.91% in the third quarter of 2004 primarily due to higher short-term interest rates in the current year quarter which resulted in both higher deposit and borrowing costs. Interest expense on deposits increased \$398,000 or 110.6% to \$758,000 for the quarter ended September 30, 2005 from \$360,000 in the prior year quarter. Average deposit balances increased \$31.2 million or 38.0% to \$113.3 million in the quarter ended September 30, 2005 from \$82.1 million in the prior year quarter due to an increase in certificate of deposit and checking account balances. The average cost of deposits increased 93 basis points to 2.68% in the quarter ended September 30, 2005 from 1.75% in the prior year quarter. Interest expense on FHLB advances and other debt, including subordinated debentures, declined \$2,000 to \$202,000 in the quarter ended September 30, 2005 from \$204,000 in the prior year quarter due to a decline in average borrowing balances of \$16.7 million in the quarter ended September 30, 2005 to \$19.1 million compared to \$35.8 million in the prior year quarter offset by a 195 basis point increase in borrowing costs to 4.23% in the third quarter of 2005 from 2.28% in the prior year quarter.

Net interest margin increased 18 basis points to 3.45% for the quarter ended September 30, 2005 compared to 3.27% in the prior year quarter.

*Provision for Loan Losses.* Management analyzes the adequacy of the allowance for loan losses regularly through reviews of the performance of the loan portfolio considering economic conditions, changes in interest rates and the effect of such changes on real estate values and changes in the composition of the loan portfolio. The allowance for loan losses is established through a provision for loan losses based on management's evaluation of the risk in its loan portfolio. Such evaluation, which includes a review of all loans for which full collectibility may not be reasonably assured, considers, among other matters, the estimated fair value of the underlying collateral, economic conditions, historical loan loss experience, changes in the size and growth of the loan portfolio and other factors that warrant recognition in providing for an adequate loan loss allowance. Future additions to the allowance for loan losses will be dependent on these factors.

Based on management's review, the provision for loan losses declined \$246,000 to \$50,000 in the third quarter of 2005 from \$296,000 in the prior year quarter due to a \$5.1 million decline in commercial, commercial real estate and multi-family loan balances during the quarter ended September 30, 2005 compared to growth of \$15.1 million during the prior year quarter. The provision for loan losses during the current year quarter primarily represents additional reserves on our mortgage portfolio, which incurred \$65,000 in write-offs during the quarter ended September 30, 2005. At September 30, 2005, the allowance for loan losses represented 1.1% of total loans compared to .8% at September 30, 2004. Nonperforming loans, all of which are nonaccrual loans, increased \$320,000 to \$606,000 or .6% of total loans at September 30, 2005 compared to \$286,000 or .3% of total loans at December 31, 2004 due to an increase in delinquent single-family mortgage loans. More than 97% of the nonaccrual loan balances are secured by single-family homes in our primary market area. Management believes the allowance for loan losses is adequate to absorb probable incurred credit losses in the loan portfolio at September 30, 2005, however future additions to the allowance may be necessary based on changes in economic conditions and the factors discussed in the previous paragraph.

*Noninterest Income.* Noninterest income increased \$105,000 to \$161,000 in the third quarter of 2005 from \$56,000 in the third quarter of 2004 due to increased gains on sales of loans in the current year quarter and losses on security sales in the prior year quarter which were not repeated in the current period. Gains on sales of loans increased \$35,000 to \$54,000 in the current year quarter from \$19,000 in the prior year period due to increased mortgage originations and sales. We sell loans on a servicing released basis.

**Table of Contents**

*Noninterest Expense.* Noninterest expense, excluding the impairment loss on goodwill and intangible assets, decreased \$156,000 to \$1.7 million in the third quarter of 2005 from \$1.8 million in the prior year period which included approximately \$320,000 related to employee severance expenses, post-retirement life insurance benefits associated with bank-owned life insurance and expenses recognized in connection with the servicing of loans and internal operating account write-offs. Operating costs of Reserve totaled \$185,000 during the current year quarter compared to none in the prior year period ended September 30, 2004, as the acquisition of Reserve was completed in October 2004.

*Income Taxes.* The income tax benefit associated with the pretax loss for the quarter ended September 30, 2005 totaled \$237,000 compared to a \$355,000 tax benefit in the prior year quarter. The goodwill impairment loss recognized in the current year quarter was not deductible for tax purposes.

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

*General.* We incurred a net loss for the nine months ended September 30, 2005 of \$2.6 million or \$1.19 per diluted share, compared to a net loss of \$1.2 million or \$.61 per diluted share for the nine months ended September 30, 2004. The current year period included a \$1.9 million, or \$.86 per diluted share impairment loss discussed above. Not including the impairment loss, the current year period loss totaled \$734,000 or \$.33 per diluted share, a 40% improvement from the prior year period. The current period loss (excluding the impairment loss) was due to \$174,000 net operating losses of the bank's mortgage services division, the expense associated with increasing the reserve for loan losses and operating costs necessary to support our growth plan.

*Net Interest Income.* The tables below titled Average Balances, Interest Rates and Yields and Rate/ Volume Analysis of Net Interest Income provide important information on factors impacting net interest income and should be read in conjunction with this discussion of net interest income.

Net interest income increased 27.4% to \$3.6 million for the nine months ended September 30, 2005 from \$2.9 million in the prior year period due to growth in assets in accordance with our growth plan. Both the volume and yield on interest-earning assets increased in the first nine months of 2005 compared to the prior year period. The resultant growth in interest income was partially offset by increased interest expense related to funding loan growth due to an increase in volume and cost of interest-bearing liabilities in the current year period.

Average interest earning assets increased \$30.7 million or 27.2% to \$143.7 million in the first nine months of 2005 from \$113.0 million in the prior year period due to loan growth pursuant to our strategy to expand into business banking services in the Fairlawn and Columbus, Ohio markets. The yield on interest earning assets increased 74 basis points to 5.78% in the first nine months of 2005 from 5.04% in the prior year period reflecting higher yields on commercial, commercial real estate and multi-family loans. Interest income increased \$1.9 million or 46.1% to \$6.2 million in the first nine months of 2005 from \$4.3 million in the prior year period due to growth in interest income on loans, which increased \$2.0 million or 58.5% to \$5.3 million for the nine months ended September 30, 2005 from \$3.3 million in the prior year period. Average loan balances increased \$37.6 million, or 50.5% to \$112.0 million in the first nine months of 2005 from \$74.4 million in the prior year period and the average yield on loans increased 32 basis points to 6.28% in the first nine months of 2005 from 5.96% in the prior year period due to commercial, commercial real estate and

**Table of Contents**

multi-family mortgage loan growth and an increase in yields on home equity lines of credit caused by the increase in short-term market interest rates and the resultant increase in the prime rate.

Average interest-bearing liabilities increased \$30.7 million or 30.1% to \$132.6 million in the first nine months of 2005 from \$101.9 million in the prior year period due to growth in deposits. The average cost of interest-bearing liabilities increased 76 basis points or 41.3% to 2.60% in the first nine months of 2005 from 1.84% in prior year period primarily due to higher short-term interest rates in the current year period which resulted in both higher deposit and borrowing costs. Interest expense on deposits increased \$946,000 or 95.3% to \$1.9 million for the nine months ended September 30, 2005 from \$1.0 million in the prior year period. Average deposit balances increased \$31.9 million or 41.9% to \$108.1 million in the nine months ended September 30, 2005 from \$76.2 million in the prior year period due to an increase in certificate of deposit and checking account balances. The average cost of deposits increased 65 basis points to 2.39% in the nine months ended September 30, 2005 from 1.74% in the prior year. Interest expense on FHLB advances and other debt, including subordinated debentures increased \$234,000 to \$646,000 in the nine months ended September 30, 2005 from \$412,000 in the prior year period due to a 139 basis point increase in borrowing costs to 3.53% in the first nine months of 2005 from 2.14% in the prior year period.

Net interest margin was 3.38% for the nine months ended September 30, 2005, unchanged from the prior year period.

*Provision for Loan Losses.* Based on management's review of the factors and market conditions discussed above, the provision for loan losses increased \$36,000 to \$402,000 in the first nine months of 2005 from \$366,000 in the prior year period. The provision for loan losses reflects growth in commercial, commercial real estate and multi-family loans and additional reserves on our mortgage portfolio in the current year period as discussed previously.

*Noninterest Income.* Noninterest income increased \$391,000 or 138.7% to \$673,000 in the first nine months of 2005 from \$282,000 in the prior year period due to increased mortgage originations and sales which resulted in \$361,000 in gains on sales of loans in the nine months ended September 30, 2005, a \$298,000 increase from \$63,000 in the prior year period.

*Noninterest Expense.* Noninterest expense excluding the impairment loss on goodwill and intangible assets increased \$446,000 to \$5.1 million in the first nine months of 2005 from \$4.7 million in the prior year period which included approximately \$320,000 related to employee severance expenses, post-retirement life insurance benefits associated with bank owned life insurance and expenses recognized in connection with the servicing of loans and internal operating account write-offs. Operating costs of Reserve totaled \$681,000 during the current year period. As the acquisition of Reserve was completed in October 2004, there were no operating costs in the nine-month period ended September 30, 2004.

*Income Taxes.* The income tax benefit associated with the pretax loss for the nine months ended September 30, 2005 totaled \$547,000 compared to a \$683,000 tax benefit in the prior year period. The goodwill impairment loss recognized in the current year period was not deductible for tax purposes.

**Comparison of Results of Operations for 2004 and 2003**

*General.* We incurred a net loss of \$1.7 million or \$.82 per diluted share in 2004, a 30.0% improvement from the net loss of \$2.4 million or \$1.31 per diluted share in 2003 primarily due to higher net interest income offset by additional provision for loan losses, a decline in gains on loan sales and increased noninterest expense.

**Table of Contents**

*Net Interest Income.* Net interest income is a significant component of our net income, and consists of the difference between interest income generated on interest-earning assets and interest expense incurred on interest-bearing liabilities. Net interest income is primarily affected by the volumes, interest rates and composition of interest-earning assets and interest-bearing liabilities. The tables below titled *Average Balances, Interest Rates and Yields* and *Rate/ Volume Analysis of Net Interest Income* provide important information on factors impacting net interest income and should be read in conjunction with this discussion of net interest income.

Net interest income totaled \$4.0 million in 2004 compared to \$1.9 million in 2003. Net interest income in 2003 included a \$1.3 million pre-tax prepayment penalty incurred in the repayment of long-term, fixed-rate FHLB advances, discussed below. Not including this prior year charge, net interest income increased 25.5% in 2004 compared to the 2003. The improvement in net interest income was due to the growth in assets, primarily commercial, commercial real estate and multi-family mortgage loans in accordance with our growth strategy and a reduction in the cost of borrowings in 2004 due to payoff of the FHLB advances, noted above, and lower market interest rates.

Interest income increased \$709,000 or 13.0% to \$6.1 million in 2004, compared to \$5.4 million in 2003, primarily due to increased income on loans and short term cash investments offset by a decline in income on securities. Interest income on loans increased \$652,000, or 15.5% in 2004 to \$4.9 million, compared to \$4.2 million in 2003, primarily due to growth in loan balances offset by lower yields on loans. Average loan balances increased \$24.5 million and totaled \$81.9 million in 2004 compared to \$57.4 million in 2003 primarily due to loan growth pursuant to our strategy to expand into business banking in the Fairlawn and Columbus, Ohio markets. Average loan yields declined 139 basis points to 5.93% in 2004 compared to 7.32% in 2003 due to growth in commercial, commercial real estate and multi-family mortgage loans, which are primarily adjustable rate loans at lower rates than single-family mortgage loans, which comprised 59.6% of the loan portfolio in 2003 compared to 37.9% in 2004. Interest income on federal funds sold and other earning assets totaled \$367,000 in 2004 and increased \$215,000, or 141.4% from \$152,000 in 2003 due to an increase in both the average balance and yield of other earning assets. The average balance of other earning assets increased \$4.9 million and totaled \$17.3 million in 2004 compared to \$12.4 million in 2003 as we maintained short term cash balances in anticipation of loan growth. The yield on other earning assets increased 90 basis points to 2.12% in 2004 from 1.22% in 2003 as market interest rates increased during 2004. Interest income on securities declined \$169,000 or 18.0% and totaled \$770,000 in 2004 compared to \$939,000 in 2003 primarily due to a decline in the average balance of securities. The average balance of securities declined \$4.1 million and totaled \$19.6 million in 2004 compared to \$23.7 million in 2003 due to cash flows from maturities and sales of securities generally invested in short term cash investments in anticipation of loan growth. The yield on securities was 4.01% in 2004 compared to 4.02% in 2003. The average balance of interest-earning assets increased \$25.4 million and the average yield of interest-earning assets declined 59 basis points during 2004.

Interest expense, not including the \$1.3 million prepayment penalty, decreased \$102,000 or 4.5% to \$2.1 million in 2004 compared to \$2.2 million in 2003 due to a decline in interest expense on deposits offset by an increase in interest expense on borrowings. Interest expense on deposits decreased \$134,000 or 8.5% to \$1.4 million in 2004 from \$1.6 million in 2003 due to a decline in the cost of deposits offset by an increase in the deposit balances. The average cost of deposits declined 35 basis points to 1.79% in 2004 from 2.14% in 2003. Average deposit balances increased \$6.9 million to \$80.3 million in 2004 from \$73.4 million in 2003 primarily due to our success in building deposit relationships with business loan customers. Interest expense on FHLB advances and other borrowings, including subordinated debentures, increased \$32,000 or 4.7% to \$713,000 in

**Table of Contents**

2004 from \$681,000 in 2003, not including the \$1.3 million prepayment penalty, due to increased borrowings offset by a decline in the average cost of borrowings. The average balance of FHLB advances and other borrowings increased \$19.1 million to \$31.3 million in 2004 from \$12.2 million in 2003 as borrowings were used to fund loan growth and short term cash investments. The average cost of FHLB advances and other borrowings decreased 331 basis points to 2.28% in 2004 from 5.59% in 2003 primarily due to payoff of long-term, fixed-rate FHLB advances in 2003. The average balance of interest-bearing liabilities increased \$25.9 million and the average cost of interest-bearing liabilities declined 70 basis points in 2004. Net interest margin declined one basis point from 3.28% in 2003 to 3.27% in 2004.

*Provision for Loan Losses.* Based on management's review of the adequacy of the allowance for loan losses, the provision for loan losses totaled \$646,000 in 2004, an increase of \$544,000 from \$102,000 in 2003. Our strategy to expand into business financial services and the significant growth in commercial, commercial real estate and multi-family mortgage loans that resulted from that strategy in 2004 required an increase in the provision and allowance for loan losses related to these loan types. At December 31, 2004, the allowance for commercial, commercial real estate and multi-family mortgage loans totaled \$862,000, an increase of \$762,000 from \$100,000 at December 31, 2003 as these loan types grew from 17.8% of the total loan portfolio at year-end 2003 to 48.3% at year-end 2004. 88.4% of the allowance was allocated to these loan types at December 31, 2004, as they tend to be larger balance, higher risk loans than single-family residential mortgages, where we have experienced low historical loss rates. At December 31, 2004, the allowance for loan losses represented 0.90% of total loans compared to 0.71% at December 31, 2003. Further, nonperforming loans, all of which are nonaccrual loans, were \$286,000 at December 31, 2004 and \$741,000 at December 31, 2003. At December 31, 2004, nonaccrual loans represented 0.3% of total loans, compared to 1.3% at December 31, 2003. The decline in nonaccrual loans was principally due to our acquisition of properties through the foreclosure process. More than 96% of the nonaccrual loan balances are secured by single-family homes in our primary market area.

*Noninterest Income.* Noninterest income declined \$219,000 or 29.0% to \$537,000 in 2004, compared to \$756,000 in 2003, primarily due to losses on security sales and decreased gains on sales of loans offset by increased loan servicing fees. Net losses on sales of securities, which totaled \$55,000 in 2004 compared to gains of \$42,000 in 2003, were primarily from sales of fixed-rate debt securities. Gains on sales of loans totaled \$222,000 in 2004, a decline of \$207,000 or 48.3% from \$429,000 during 2003 due to decreased mortgage originations and sales as market mortgage interest rates increased and customer refinancing slowed during the current year. Net loan servicing fee income totaled \$62,000 in 2004, an increase of \$163,000 from a net loss of \$101,000 in 2003, primarily a result of slower mortgage loan prepayments as market interest rates increased in 2004.

*Noninterest Expense.* Noninterest expense increased \$490,000 or 8.3% and totaled \$6.4 million in 2004 compared to \$5.9 million in 2003 primarily due to a full year of operating costs related to staffing, improved technology and expansion to new locations in Fairlawn and Columbus, including data processing, occupancy, depreciation and other expenses. Noninterest expense in 2004 also included \$106,500 in legal and professional fees related to a proposed reverse stock split and \$412,000 in expenses related to employee severance, post-retirement life insurance benefits associated with bank owned life insurance, charges recognized in connection with the servicing of loans and internal operating account write-offs. Expenses for the year ended December 31, 2003 included \$1.6 million in salaries and benefits related to restructuring of employee benefit plans and payments on agreements with former executives.

**Table of Contents**

*Income Taxes.* The income tax benefit associated with the lower net loss in 2004 totaled \$872,000 compared to \$988,000 in 2003.

*Average Balances, Interest Rates and Yields.* The following tables present for the periods indicated the total dollar amount of fully taxable equivalent interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates.

**For the Nine Months Ended September 30,**

	2005			2004		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
(Dollars in thousands)						
<b>Interest-earning assets:</b>						
Securities(1)(2)	\$ 23,375	\$ 727	4.19%	\$ 21,768	\$ 650	4.01%
Loans(3)	112,002	5,274	6.28%	74,404	3,328	5.96%
Other earning assets	4,490	86	2.55%	13,189	180	1.82%
FHLB stock	3,836	136	4.73%	3,675	112	4.06%
Total interest-earning assets	143,703	6,223	5.78%	113,036	4,270	5.04%
Noninterest-earning assets	16,224			12,103		
Total assets	\$ 159,927			\$ 125,139		
<b>Interest-bearing liabilities:</b>						
Deposits	108,135	1,939	2.39%	76,243	993	1.74%
FHLB advances and other borrowings(4)	24,416	646	3.53%	25,702	412	2.14%
Total interest-bearing liabilities	132,551	2,585	2.60%	101,945	1,405	1.84%
Noninterest-bearing liabilities	8,156			4,052		
Total liabilities	140,707			105,997		
Equity	19,220			19,142		
Total liabilities and equity	\$ 159,927			\$ 125,139		
Net interest-earning assets	\$ 11,152			\$ 11,091		
Net interest income/interest rate spread		\$ 3,638	3.18%		\$ 2,865	3.20%
Net interest margin			3.38%			3.38%
	108.4%			110.9%		

Average interest-earning  
assets to average  
interest-bearing liabilities

*(See footnotes on page 33)*



**Table of Contents****For the Year Ended December 31,**

	2004			2003		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
(Dollars in thousands)						
Interest-earning assets:						
Securities(1)(2)	\$ 19,605	\$ 780	4.01%	\$ 23,675	\$ 942	4.02%
Loans(3)	81,900	4,855	5.93%	57,449	4,203	7.32%
Other earning assets	17,329	367	2.12%	12,410	152	1.22%
FHLB stock	3,694	152	4.11%	3,557	141	3.96%
Total interest-earning assets	122,528	6,154	5.03%	97,091	5,438	5.62%
Noninterest-earning assets	13,034			11,268		
Total assets	\$ 135,562			\$ 108,359		
Interest-bearing liabilities:						
Deposits	80,305	1,436	1.79%	\$ 73,440	1,570	2.14%
FHLB advances and other borrowings(4)	31,265	713	2.28%	12,192	681	5.59%
Total interest-bearing liabilities	111,570	2,149	1.93%	85,632	2,251	2.63%
Noninterest-bearing liabilities	4,658			3,484		
Total liabilities	116,228			89,116		
Equity	19,334			19,243		
Total liabilities and equity	\$ 135,562			\$ 108,359		
Net interest-earning assets	\$ 10,958			\$ 11,459		
Net interest income/interest rate spread		\$ 4,005	3.10%		\$ 3,187	2.99%
Net interest margin			3.27%			3.28%
Average interest-earning assets to average interest-bearing liabilities	109.8%			113.4%		

- (1) Includes securities available for sale and held to maturity. Average balance is computed using the carrying value of securities. Average yield is computed using the historical amortized cost average balance for available for sale securities.
- (2) Average yields and interest earned are stated on a fully taxable equivalent basis.
- (3) Balance is net of deferred loan origination fees, undisbursed proceeds of construction loans and includes nonperforming loans.
- (4) Interest paid does not include \$1.3 million penalty on prepayment of FHLB advances in 2003.

**Table of Contents**

*Rate/ Volume Analysis of Net Interest Income.* The following table presents the dollar amount of changes in interest income and interest expense for major components of interest-earning assets and interest-bearing liabilities. It distinguishes between the increase and decrease related to changes in balances and/or changes in interest rates. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (i) changes in volume (i.e., changes in volume multiplied by the prior rate) and (ii) changes in rate (i.e., changes in rate multiplied by prior volume). For purposes of this table, changes attributable to both rate and volume which cannot be segregated have been allocated proportionately to the change due to volume and the change due to rate.

	Nine Months Ended September 30, 2005 Compared to Nine Months Ended September 30, 2004			Year Ended December 31, 2004 Compared to Year Ended December 31, 2003		
	Increase (decrease) due to			Increase (decrease) due to		
	Rate	Volume	Net	Rate	Volume	Net
(Dollars in thousands)						
<b>Interest-earning assets:</b>						
Securities(1)	\$ 28	\$ 49	\$ 77	\$ (2)	\$ (160)	\$ (162)
Loans	184	1,762	1,946	(904)	1,556	652
Other earning assets	84	(178)	(94)	140	75	215
FHLB stock	19	5	24	6	5	11
Total interest-earning assets	315	1,638	1,953	(760)	1,476	716
<b>Interest-bearing liabilities:</b>						
Deposits	448	498	946	(272)	138	(134)
FHLB advances and other borrowings(2)	268	(34)	234	(576)	608	32
Total interest-bearing liabilities	716	464	1,180	(848)	746	(102)
Net change in net interest income	\$ (401)	\$ 1,174	\$ 773	\$ 88	\$ 730	\$ 818

(1) Securities amounts presented on a fully taxable equivalent basis.

(2) Amounts do not include \$1.3 million penalty on prepayment of FHLB advances in 2003.

**Liquidity and Capital Resources**

In general terms, liquidity is a measurement of our ability to meet its cash needs. Our objective in liquidity management is to maintain the ability to meet loan commitments, purchase securities or to repay deposits and other liabilities in accordance with their terms without an adverse impact on current or future earnings. Our principal sources of funds are deposits, amortization and prepayments of loans, maturities, sales and principal receipts of securities available for sale, borrowings and operations. While maturities and scheduled amortization of loans are

predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition.

The bank is required by regulation to maintain sufficient liquidity to ensure its safe and sound operation. Thus, adequate liquidity may vary depending on the bank's overall asset/liability

**Table of Contents**

structure, market conditions, the activities of competitors and the requirements of its own deposit and loan customers. Management believes that the bank's liquidity is sufficient.

Liquidity management is both a daily and long-term responsibility of management. We adjust our investments in liquid assets, primarily cash, short-term investments and other assets that are widely traded in the secondary market, based on management's assessment of expected loan demand, expected deposit flows, yields available on interest-earning deposits and securities and the objective of its asset/liability management program. In addition to its liquid assets, we have other sources of liquidity available including, but not limited to access to advances from the FHLB, use of brokered deposits and the ability to obtain deposits by offering above-market interest rates.

The bank relies primarily on competitive rates, customer service and relationships with customers to retain deposits. Based on the bank's experience with deposit retention and current retention strategies, Management believes that, although it is not possible to predict future terms and conditions upon renewal, a significant portion of such deposits will remain with the bank.

At September 30, 2005, the bank exceeded all of its regulatory capital requirements to be considered well-capitalized with a Tier 1 capital level of \$12.2 million, or 7.8% of adjusted total assets, which exceeds the required level of \$7.8 million, or 5.0%; Tier 1 risk-based capital level of \$12.2 million, or 10.4% of risk-weighted assets, which exceeds the required level of \$7.0 million, or 6.0%; and risk-based capital of \$13.4 million, or 11.5% of risk-weighted assets, which exceeds the required level of \$11.7 million, or 10.0%. Continued operating losses may require us to infuse additional capital into the bank.

**Impact of Inflation**

The financial statements and related data presented herein have been prepared in accordance with generally accepted accounting principles, which presently require us to measure financial position and results of operations primarily in terms of historical dollars. Changes in the relative value of money due to inflation are generally not considered. In management's opinion, changes in interest rates affect our financial condition to a far greater degree than change in the inflation rate. While interest rates are generally influenced by changes in the inflation rate, they do not move concurrently. Rather, interest rate volatility is based on changes in the expected rate of inflation, as well as changes in monetary and fiscal policy. A financial institution's ability to be relatively unaffected by changes in interest rates is a good indicator of its ability to perform in a volatile economic environment. In an effort to protect itself from the effects of interest rate volatility, we review our interest rate risk position frequently, monitoring our exposure and taking necessary steps to minimize any detrimental effects on our profitability.

**Table of Contents****QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the risk of loss from adverse changes in market prices and interest rates. We have not engaged in and, accordingly, have no risk related to trading accounts, commodities, foreign exchange, hedging activities, interest rate derivatives or interest rate swaps. However, our hedging policy does allow the bank to enter into hedging activities, such as interest rate swaps, up to 10% of total assets. Our market risk arises primarily from interest rate risk inherent in our lending and deposit-taking activities and the issuance of our debentures. The measurement of market risk associated with financial instruments is meaningful only when all related and offsetting on-and off-balance sheet transactions are aggregated, and the resulting net positions are identified. Disclosures about the fair value of financial instruments as of December 31, 2004, which reflect changes in market prices and rates, are set forth in Note 19 to our consolidated financial statements. Management believes there have been no significant changes in our market risk exposure since December 31, 2004.

Management actively monitors and manages our interest rate risk exposure. The primary objective in managing interest rate risk is to limit, within established guidelines, the adverse impact of changes in interest rates on our net interest income and capital. The bank measures the effect of interest rate changes on its net portfolio value ( NPV ), which is the difference between the estimated market value of the bank's assets and liabilities under different interest rate scenarios. Changes in NPV are measured using instantaneous changes in interest rates, rather than linear changes in rates over a period of time. At June 30, 2005 (the most recent date for which data are available), the bank's NPV ratios, using interest rate shocks ranging from a 300 basis point rise in rates to a 200 basis point decline in rates are shown in the following table. All values are within the acceptable range established by our Board.

**Net Portfolio Value  
(Bank only)**

<b>Basis Point Change in Rates</b>	<b>NPV Ratio</b>
+300	10.91%
+200	11.29%
+100	11.55%
0	11.63%
-100	11.42%
-200	11.00%

In evaluating the bank's exposure to interest rate risk, certain shortcomings inherent in the method of analysis presented in the foregoing table must be considered. For example, although certain assets and liabilities may have similar maturities or periods to which they reprice, they may react in different degrees to changes in market interest rates. In addition, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Furthermore, in the event of a change in interest rates, prepayments and early withdrawal levels would likely deviate significantly from those assumed in calculating the table. Finally, the ability of many borrowers to service their debt may decrease when interest rates rise. Therefore, the actual effect of changing interest rates may differ materially from that presented in the foregoing table.

**Table of Contents**

Our interest rate risk position has improved as a result of management's strategic decisions to sell fixed-rate mortgage loan originations rather than retain long-term, low fixed-rate loans in portfolio, grow commercial loans, which tend to have shorter maturities than residential mortgage loans and, in many cases, adjustable interest rates, and extend the maturity dates of borrowings using longer-term, fixed-rate FHLB advances.

**Table of Contents**

**BUSINESS**

**General**

Central Federal Corporation is a savings and loan holding company incorporated in 1998 under the laws of the State of Delaware. We are the parent company of CFBank. We originally were chartered under the name Grand Central Financial Corp., but on April 23, 2003, we changed our name to Central Federal Corporation. Our primary business is the operation of CFBank.

At September 30, 2005 we had consolidated assets of \$157.9 million, net loans of \$107.0 million, total deposits of \$120.7 million and stockholders' equity of \$17.2 million.

CFBank is a federally-chartered savings association formed in 1892. In 1998 it converted from a mutual to a stock form of organization. Earlier known as Central Federal Savings and Loan Association, the bank changed its name to Central Federal Bank on February 20, 2003 and to CFBank on April 20, 2004. The bank is a full service community bank primarily serving the banking needs of small- to medium-sized businesses and their owners in our market area. We emphasize superior customer service and responsive decision making delivered with the convenience of modern technology.

CFBank's principal business consists of attracting deposits from the general public in its primary market area and investing those deposits and other funds generated from operations and FHLB advances, primarily in commercial real estate and business loans and conventional mortgage loans secured by single-family residences. The bank also invests in consumer loans, home equity, multi-family, construction and land loans and mortgage-backed securities, primarily those guaranteed or insured by government agencies and other investment grade securities. CFBank's revenues are derived principally from the generation of interest and fees on loans originated and, to a lesser extent, from interest and dividends on securities. The bank's primary sources of funds are retail savings deposits, principal and interest payments on loans, investment securities, FHLB advances and proceeds from the sale of loans. CFBank operates through its home office located in Fairlawn, Ohio, and full-service offices in Calcutta, Ohio, Columbus, Ohio and Wellsville, Ohio.

From the time of our mutual-to-stock thrift conversion in 1998 through 2002, we operated as an overcapitalized company exhibiting limited growth potential and earnings that were well below industry averages in terms of returns on average assets and equity. Our board of directors recognized that we needed to strengthen our management team, move into more rapidly growing markets and expand into business banking in order to be properly positioned to deliver long-term shareholder value. We believe that since the beginning of 2003 we have made significant strides to achieve those goals.

Adding experienced bankers to our management team and opening new offices in Fairlawn and Columbus has been expensive in the short-term, and our level of net interest income has not been sufficient to cover our increased overhead levels since we embarked on this strategy. We have undertaken significant restructuring costs, such as severance costs, termination of our Employee Stock Option Plan, freezing of our defined benefit plan and restructuring of FHLB debt. We believe that we have largely completed the restructuring of our management team and balance sheet, and we believe that we are poised to become a profitable community bank and to continue our growth following this offering. The capital provided by this offering will enable us to expand our lending limit and make further penetration into our new markets.

On October 22, 2004, CFBank acquired Reserve Mortgage Services, Inc., an Ohio corporation formerly known as RJO Financial Services, Inc. Reserve Mortgage Services, Inc. subsequently



## **Table of Contents**

merged with the bank and now operates as CFBank's mortgage services division, originating conventional real estate loans.

CFBank is subject to regulation by the OTS and the FDIC. *See* Regulation and Supervision at page 59.

Our management team has many years of banking experience and extensive knowledge of the markets we serve.

### **Growth**

In 2003, we put in place a strong senior management team and adopted an ambitious growth plan to reposition the bank. In that year, we began a transition from our historical role as a thrift with an emphasis on making single family mortgage loans in Columbiana County to a balanced community bank. As part of the transition, we have opened additional offices in Franklin and Summit Counties, Ohio, where higher population and median income offer far greater potential for growth and profitability. Along with our expansion into growth markets, we are shifting our focus to more fully serving the more profitable commercial and commercial real estate loan markets. We are also enhancing our mortgage loan capabilities. We intend to consider every reasonable channel to originate loans, including the internet and other technology. We will evaluate our origination channels on an ongoing basis and retain only those that prove to be profitable.

Our growth plan is working. Commercial, commercial real estate and multi-family loans increased \$12.2 million or 23.0% in the first nine months of 2005 and totaled \$64.9 million at September 30, 2005. Home equity lines of credit increased \$8.0 million or 134.8% in the first nine months of 2005 and totaled \$13.9 million at September 30, 2005. Deposits increased \$19.1 million or 18.8% during the first nine months of 2005 and totaled \$120.7 million at September 30, 2005.

This growth positively impacted our net interest income which increased 16.5% and 27.4% and totaled \$1.2 million and \$3.6 million for the three and nine months ended September 30, 2005 compared to \$1.1 million and \$2.9 million for the prior year periods.

### **Market Area and Competition**

Our principal market area for customer loans and deposits includes Summit, Franklin and Columbiana County, Ohio. We originate commercial and conventional real estate loans and business loans throughout Ohio.

Historically, our primary market area for customer deposits and loans was Columbiana County, Ohio, where two of our offices are located. The East Liverpool-Salem Metropolitan Statistical Areas (MSA), which includes Columbiana County, has a population in 2005 of 110,000 and a median household income of \$39,000, according to SNL Financial. The Columbiana County market, while stable and important to us, is experiencing stagnant to slightly declining population growth, and its median household income is well below the statewide median of \$49,000. However, while not a growth area, Columbiana County has the 15th highest level of deposits of the state's 88 counties.

When we changed management and the strategic direction of the bank beginning in 2003, we entered two markets which exhibit substantially greater growth potential, as well as a far greater concentration of potential business banking customers. The Akron MSA, which is served by our Fairlawn office, had an estimated 2005 population of 710,000 and a median household income level of \$52,000. The Columbus MSA is even more attractive, with an estimated 2005 population of 1.8 million and a median household income of \$54,000. All demographic information has been obtained from SNL Financial.

**Table of Contents**

Our primary market area is a competitive market for financial services; we face competition both in making loans and in attracting deposits. Direct competition comes from a number of financial institutions operating in our market area, many with a statewide or regional presence, and, in some cases, a national presence. Many of these financial institutions are significantly larger and have greater financial resources than we. Competition for loans and deposits comes from savings institutions, mortgage banking companies, commercial banks and credit unions, brokerage firms and insurance companies.

In terms of bank deposits as of June 30, 2005 (the most recent date for which data are available), according to the FDIC, the East Liverpool-Salem MSA had \$2.0 billion in total deposits. By contrast, the Akron MSA had \$9.9 billion and the Columbus MSA had \$28.8 billion. Our Fairlawn office is in close proximity to the Cleveland MSA, which had \$64.5 billion, the highest level in the state. While we recognize that we have many well-established competitors in our new markets, we believe that we will be able to achieve significant growth in these markets over the next several years.

We also extend our reach by utilizing technology and services to gather deposits without requiring customers to visit our offices. Customers may access their accounts through our website, [www.CFBankonline.com](http://www.CFBankonline.com), and make deposits through any of the 814 ATMS in the network to which we belong, through a local courier service we provide or through the use of check scanners which can be onsite at a client's office, enabling immediate recognition of funds.

**Lending Activities**

*Loan Portfolio Composition.* Our loan portfolio consists primarily of commercial real estate loans and mortgage loans secured by single-family and multi-family residences. At September 30, 2005, gross loans receivable totaled \$108.4 million. Commercial, commercial real estate and multi-family mortgage loans totaled \$64.9 million and represented 59.8% of the gross loan portfolio at September 30, 2005, compared to 48.3% at December 31, 2004 and 17.8% at December 31, 2003. The increase in the percentage of commercial, commercial real estate and multi-family mortgage loans in the portfolio was a result of the growth strategy implemented in 2003 to transform the bank from a traditional single-family mortgage lending thrift into a community bank. Single-family residential mortgage loans totaled \$23.4 million and represented 21.6% of the gross loan portfolio at September 30, 2005 compared to \$41.4 million or 38.0% of total gross loans at year-end 2004 and \$34.8 million or 59.6% at year-end 2003. In a transaction with Freddie Mac in the second quarter of 2005, we securitized single-family residential mortgage loans held in our portfolio with an outstanding principal balance of \$18.6 million, reducing single-family mortgage loan balances. The remainder of the portfolio consisted of consumer loans which totaled \$20.2 million, or 18.6% of gross loans receivable at September 30, 2005 compared to \$14.0 million or 12.8% at December 31, 2004 and \$12.6 million or 21.6% at December 31, 2003. The increase in consumer loans was due to increased home equity lines of credit, which totaled \$13.9 million or 12.9% of the gross loan portfolio at September 30, 2005 compared to \$5.9 million or 5.4% at December 31, 2004 and \$1.6 million or 2.8% at December 31, 2003. Auto loans declined during the periods to \$4.7 million or 4.3% of the gross loan portfolio at September 30, 2005 from \$6.7 million or 6.2% at year-end 2004 and \$9.3 million or 15.9% at year-end 2003. At September 30, 2005, 25.4% of the loan portfolio had fixed rates, compared to 32.8% at year-end 2004 and 55.7% at year-end 2003. The decline in the percentage of fixed rate loans in the portfolio was a result of growth in commercial, commercial real estate and multi-family mortgage loans, as well as home equity lines of credit during 2004 and 2005, which are predominantly adjustable rate loans.

**Table of Contents**

Interest rates charged on loans are affected by the demand for such loans and the supply of money available for lending purposes and the rates offered by competitors. In turn, these factors are affected by, among other things, economic conditions, fiscal policies of the federal government, the monetary policies of the Federal Reserve Board and legislative tax policies.

The following table sets forth the composition of the loan portfolio in dollar amounts and as a percentage of the portfolio at the dates indicated.

	<b>At December 31,</b>							
	<b>At September 30, 2005</b>		<b>2004</b>		<b>2003</b>		<b>2002</b>	
	<b>Amount</b>	<b>Percent of Total</b>	<b>Amount</b>	<b>Percent of Total</b>	<b>Amount</b>	<b>Percent of Total</b>	<b>Amount</b>	<b>Percent of Total</b>
<b>(Dollars in thousands)</b>								
<b>Real estate mortgage loans:</b>								
Single-family	\$ 23,352	21.6%	\$ 41,450	38.0%	\$ 34,810	59.6%	\$ 47,108	74.8%
Multi-family	25,620	23.6%	25,602	23.4%	1,250	2.1%	1,536	2.5%
Construction		0.0%	1,127	1.0%	610	1.1%	134	0.2%
Commercial real estate	26,753	24.7%	20,105	18.4%	5,040	8.6%		0.0%
Total real estate mortgage loans	75,725	69.9%	88,284	80.8%	41,710	71.4%	48,778	77.5%
<b>Consumer loans:</b>								
Home equity loans	880	0.8%	663	0.6%	1,003	1.7%	1,378	2.2%
Home equity lines of credit	13,921	12.9%	5,928	5.4%	1,640	2.8%	1,109	1.8%
Automobile	4,684	4.3%	6,735	6.2%	9,292	15.9%	10,540	16.7%
Other	696	0.6%	626	0.6%	663	1.2%	877	1.4%
Total consumer loans	20,181	18.6%	13,952	12.8%	12,598	21.6%	13,904	22.1%
Commercial loans	12,481	11.5%	7,030	6.4%	4,116	7.0%	261	0.4%
Total loans receivable	108,387	100.0%	109,266	100.0%	58,424	100.0%	62,943	100.0%
<b>Less:</b>								
Net deferred loan fees	(163)		(139)		15		(17)	
Allowance for loan losses	(1,225)		(978)		(415)		(361)	

Loans receivable, net	\$ 106,999	\$ 108,149	\$ 58,024	\$ 62,565
--------------------------	------------	------------	-----------	-----------

*Loan Maturity.* The following tables show the remaining contractual maturity of the loan portfolio at September 30, 2005 and December 31, 2004. Demand loans and other loans having no

**Table of Contents**

stated schedule of repayments or no stated maturity are reported as due within one year. The table does not include potential prepayments or scheduled principal amortization.

<b>At September 30, 2005</b>				
	<b>Single-family, Multi-family and Construction Real Estate Mortgage</b>	<b>Consumer</b>	<b>Commercial and Commercial Real Estate</b>	<b>Total Loans Receivable</b>
(Dollars in thousands)				
<b>Amounts due:</b>				
Within one year	\$ 1,329	\$ 2,273	\$ 11,080	\$ 14,682
<b>After one year:</b>				
More than 1 year to 3 years	327	2,449	4,115	6,891
More than 3 years to 5 years	420	3,813	6,143	10,376
More than 5 years to 10 years	21,182	1,333	6,330	28,845
More than 10 years to 15 years	8,017	39	7,981	16,037
More than 15 years	17,697	10,274	3,585	31,556
<b>Total due after one year</b>	<b>47,643</b>	<b>17,908</b>	<b>28,154</b>	<b>93,705</b>
<b>Total amount due</b>	<b>\$ 48,972</b>	<b>\$ 20,181</b>	<b>\$ 39,234</b>	<b>\$ 108,387</b>

**At December 31, 2004**

	<b>Single-family, Multi-family and Construction Real Estate Mortgage</b>	<b>Consumer</b>	<b>Commercial and Commercial Real Estate</b>	<b>Total Loans Receivable</b>
--	--	-----------------	--	---------------------------------------